

DOCUMENT RESUME

ED 266 045

SO 016 504

AUTHOR Anderson, Annelise; And Others
TITLE Presidential Initiative for the Second Term. Report of the Committee on the Next Agenda.
INSTITUTION Hudson Inst., Indianapolis, IN.
PUB DATE 15 Jan 85
NOTE 64p.
AVAILABLE FROM Director of Development, Hudson Institute, 620 Union Drive, P.O. Box 648, Indianapolis, IN 46206 (\$8.00).
PUB TYPE Reports - Descriptive (141)
EDRS PRICE MF01 Plus Postage. PC Not Available from EDRS.
DESCRIPTORS Advisory Committees; Economic Climate; Economic Development; *Federal Government; Federal Programs; *Foreign Policy; *Government Role; Long Range Planning; National Security; *Planning Commissions; Policy Formation; Politics; *Public Policy; *Social Change
IDENTIFIERS Presidential Initiatives; *Reagan Administration; Strategic Defense Initiative

ABSTRACT

Based on the Committee on the Next Agenda's analysis of four major aspects of public policy, recommended presidential initiatives for President Reagan's second term in office are outlined. Biographic information about Committee members and a summary of initiatives preface the report. Section I examines initiatives related to the role of government in a free society. Section II "Domestic and International Economic Policy," presents short-and long-range economic policy objectives for 1981 and 1985. The third section, "U.S. Foreign Policy and National Security," presents constraints to a coherent foreign policy (including friction between the Congress and executive branch and reforms within the executive branch), and maintenance of national security via President Reagan's Strategic Defense Initiative (SDI). Suggestions for cost-effective defense are followed by discussion of regional issues such as U.S. involvement in Central America, U.S. security interests, and achievement of U.S. objectives. Recommended ways of maintaining the diplomatic initiative precede the final section which examines the need for a new social contract. Topics in this section include information on the legal system, government and ethics, poverty and welfare dependency, education and American culture, health care delivery, the work force, and immigration. (LH)

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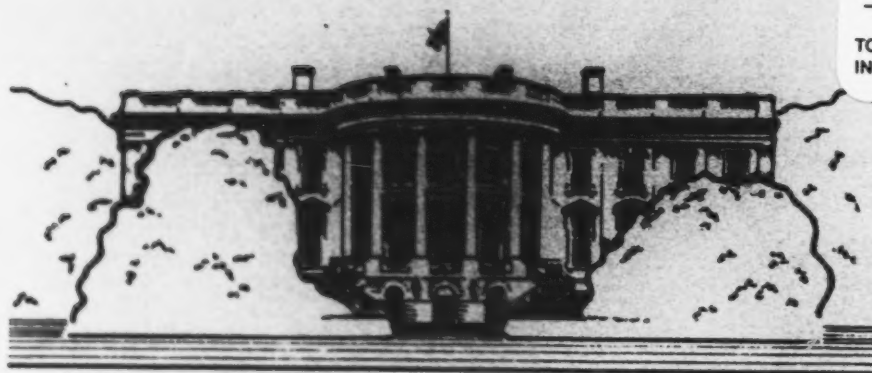
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Presidential Initiatives
for the
Second Term

January 15, 1985



REPORT OF THE
COMMITTEE ON THE NEXT AGENDA

Presidential Initiatives
for the
Second Term

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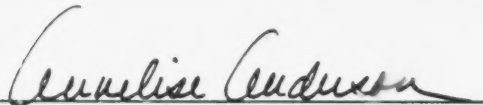


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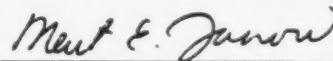
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*For further information, contact Thomas D. Bell, Jr. (President, Hudson Institute)
or Kathryn F. Hubbard (Director of Development).*

MEMBERS OF THE COMMITTEE ON THE NEXT AGENDA



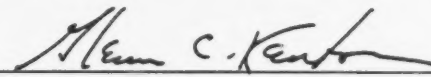
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Hoover Institution



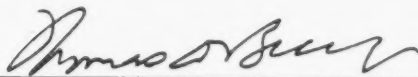
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Hudson Institute



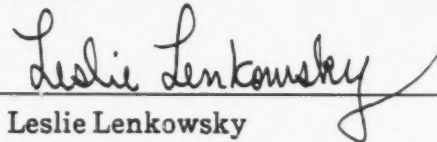
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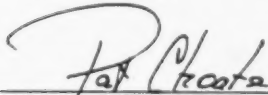
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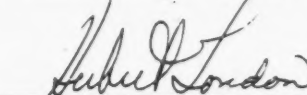
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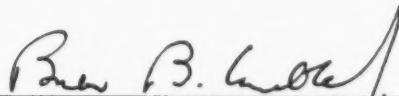
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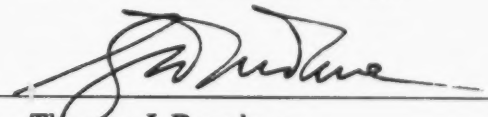
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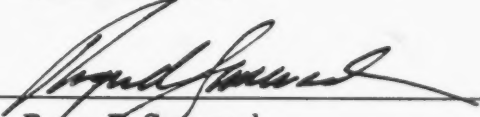
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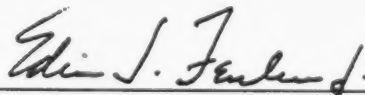
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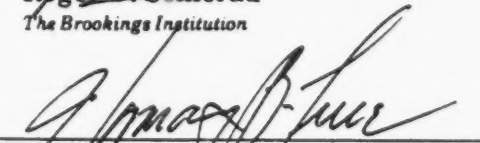
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American Trucking Associations



Roger D. Semerad
The Brookings Institution



Edwin J. Feulner
The Heritage Foundation



Norman Ture
Institute on the Research of Economics of Taxation

BIOGRAPHIES OF MEMBERS OF THE COMMITTEE

Dr. Annelise Anderson

Dr. Anderson is currently a Senior Research Fellow of the Hoover Institution on War, Revolution and Peace. She formerly served as an Associate Director of the Office of Management and Budget from 1981 to 1983, and prior to joining the Reagan Administration, Dr. Anderson was an Associate Professor at California State University, Hayward.

Dr. Martin Anderson

Dr. Anderson is a Senior Fellow at the Hoover Institution on War, Revolution and Peace and was formerly the Assistant to President Reagan for Domestic Policy in 1981-82. He currently serves as a member of the President's Foreign Intelligence Advisory Board and of the President's Economic Policy Advisory Board.

Mr. Thomas D. Bell, Jr.

Mr. Bell is President and Chief Executive Officer of the Hudson Institute, which recently relocated to Indianapolis, Indiana. He formerly served as Executive Vice President of Citizen's Choice, a national business organization founded by the U.S. Chamber of Commerce and as Administrative Assistant to Senator Bill Brock (R-TN).

Dr. Pat Choate

Dr. Choate is Director of Policy Analysis for TRW. He was a Senior Fellow at the Academy for Contemporary Problems and formerly served as Director of Economic Research for the Economic Development Administration of the U.S. Department of Commerce and Commissioner of Economic Development for the State of Tennessee.

The Honorable Barber B. Conable, Jr.

Mr. Conable served 10 consecutive terms in the U.S. House of Representatives (R-NY) where he was Ranking Republican of the House Ways and Means Committee. Prior to his election to the House, Congressman Conable served as a member of the New York State Senate. He is now a Senior Fellow of the American Enterprise Institute.

Mr. Thomas J. Donohue

Mr. Donohue is President and Chief Executive Officer of the American Trucking Associations. He formerly served as a Group Vice President for the Chamber of Commerce of the U.S., Executive Vice President of the National Chamber Foundation and Assistant Post Master General.

Dr. Edwin J. Feulner

Dr. Feulner is President of the Heritage Foundation. He also serves as Chairman of the U.S. Advisory Commission on Public Diplomacy and is the former Executive Director of the Republican Study Committee of the U.S. House of Representatives.

Ms. Merit Janow

Ms. Janow is a Research Fellow with the Hudson Institute specializing in political economics and Asian studies. She has contributed to Hudson studies on international trade in specific countries and on economic, political, and social trends affecting corporate planning.

The Honorable Glenn C. Kenton

Mr. Kenton is an attorney who has served as Secretary of State for the State of Delaware since 1977. Prior to his appointment to state office, he was the attorney for the Delaware House of Representatives.

Dr. Leslie Lenkowsky

Dr. Lenkowsky is the former Deputy Director of the U.S. Information Agency. He also served as Director of Research for the Smith Richardson Foundation and Assistant to Dr. Patrick Moynihan at Harvard. He now serves as a Research Fellow of the American Enterprise Institute.

Dr. Herbert I. London

Dr. London is a Senior Fellow and Director of the Visions of the Future program at the Hudson Institute. He is currently on sabbatical from New York University where he serves as Dean of the Gallatin Division.

Mr. Glenn R. Pascall

Mr. Pascall has been Director of Revenue of the State of Washington, President of the Washington State Research Council, and Director of Research of the California Taxpayers Association. He is now an independent consultant whose clients include state governments and major corporations.

Mr. Roger D. Semerad

Mr. Semerad is Executive Vice President of the Brookings Institution and Chairman of the Board of 70001, Ltd., a national public service corporation that trains and places disadvantaged youth in private sector jobs. He formerly served as Domestic Policy Advisor to Presidents Nixon and Ford. He was Executive Director of the Republican National Committee Policy Councils from 1976 to 1980, and in 1980 was Executive Director of the Republican Platform Committee.

Dr. Norman B. Ture

Dr. Ture is President of the Institute for Research on the Economics of Taxation and Economic Affairs, a private nonprofit organization based in Washington, D.C. He formerly served as Under Secretary of the Treasury for Taxation and Economic Affairs.

FOREWORD

There is a growing consensus among policy analysts that fundamental questions regarding the role and scope of government must be reexamined. As he begins his second term, President Reagan faces a central challenge: how to pursue governmental policies that promote long-term economic vitality--and that are compassionate, dynamic, and affordable.

More fundamentally, this raises questions of governance: What is the proper function of government today? What is its most useful and legitimate role, at home and abroad? Where are the opportunities for new and creative policy initiatives, and which areas demand renewed attention?

Accordingly, Hudson Institute formed the Committee on the Next Agenda in mid-1984 to discuss the role of the U.S. government--particularly the role of the President--vis-a-vis the major economic, political, social, and foreign policy issues of the day. Members of the committee have not participated as representatives of their organizations per se,

but have contributed their efforts as individuals.

This private initiative was explicitly intended to produce a broad policy document for the White House--to thereby stimulate discussion and decision making within the government and the policy community at large.

Early on, the committee formed four separate subcommittees, reflected in this document, to focus on specific policy areas that any administration--be it Republican or Democratic--must address. Each subcommittee, drawing on its members and outside contributors, then prepared working papers that were presented to the full committee for discussion and review. During the review process, opinions naturally varied on specific points of substance and emphasis. Extensive discussions and redrafting resulted in a clarification of our areas of concern and consensus.

The document that follows has all the peculiarities of a report written by

NOTE: This effort was initiated and funded by Hudson Institute as part of its independent research program. No additional funding has been received for this project. Each contributor's participation was completely voluntary, and donated in the hope that the final report would help the President and the nation deal with some of the more difficult policy questions of the day.

a committee. When we believed an issue or problem was well understood by our audience, we simply provided straightforward recommendations. When we felt the issue or problem was largely misunderstood or that conventional wisdom had strayed from the mark, we spent much time and effort on explanations as well as recommendations.

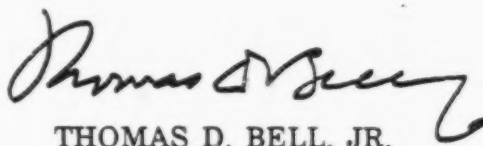
Of course, we recognized early on that we could not address every major issue. Therefore, we carefully chose important issues where we thought our efforts would yield the best counsel and have the most influence.

In one of our early sessions, Bill Baroody reminded us of Franklin D.

Roosevelt's famous 1933 inaugural address in which he said:

... We do not distrust the future of essential democracy. The people of the United States have not failed. In their need they have registered a mandate that they want direct, vigorous action. They have asked for discipline and direction under leadership.

We believe our government has strayed too far from such guiding principles during the intervening years. Hopefully, this document can help refocus today's debate on some fundamental dimensions of current policy questions.



THOMAS D. BELL, JR.
Chairman, Committee on the
Next Agenda
President, Hudson Institute

SUMMARY

As he enters his second term, President Reagan faces the task of reasserting his vision of the proper role of government in domestic and foreign affairs. Bold initiatives are needed to further reduce the social and economic burdens that have been imposed by the expansion of government power, and to promote the growth and efficiency of private institutions. The nation's overseas interests and security must be further strengthened by casting off the last remnants of self-doubt and reassuming the mantle of world leadership.

The Committee on the Next Agenda was formed to offer recommendations that would help the President formulate policies and programs to attain these broad goals. The committee's recommendations flow from its analyses of these main aspects of public policy:

- The role of government in a free society
- Economic and social policy
- Foreign policy and national security.

THE ROLE OF GOVERNMENT IN A FREE SOCIETY

The committee's analysis of this issue provides the framework for its

examination of the other public-policy areas and for its recommendations in each of those areas.

Concentration of power in the hands of government has undermined two fundamental traditions: reliance on individual responsibility as the force for economic progress and reliance on the family as the source of social stability. A market-based system--one built upon voluntary exchange between individuals--is the only economic system compatible with a "free" political system. The extension of government power not only limits the efficiency of such voluntary exchanges but also creates a dependence on the government for solutions to problems that are best dealt with by private institutions.

Another fundamental change has been the increasing encroachment of the judicial process into the traditional prerogatives of the executive and legislative branches of government. De facto legislation by the courts and over-litigation of private and public matters have wrought great harm to the integrity of our governmental, social, and economic institutions.

Moreover, the growth of government power--and the shift of power from state and local governments to the federal government--has created a climate for the proliferation of special-interest groups, which often promote

their aims at the expense of general economic and social welfare.

The federal government, of course, has legitimate functions--many of which require the exercise of strong Presidential leadership. The day-to-day involvement of Congress in the formulation and conduct of foreign policy and national security affairs, for example, often hinders rather than helps our relations with allies and negotiations with adversaries. The disjointed way in which Congress treats individual components of the President's budget leads to the enactment of bits and pieces of programs, instead of promoting the execution of coherent policies.

Clearly, the times call for bold Presidential initiatives--not for the sake of placing more power in the hands of government, but for these ends:

- To restore and preserve the proper balance between government power and individual responsibility, and between the executive and legislative branches of government
- To ensure that economic and social freedom is served by a coherent foreign policy and preserved through a rational national-security policy.

ECONOMIC AND SOCIAL POLICY

These are the fundamental problems of the U.S. economy and society:

- In economic affairs, the tax structure and the structure of government expenditures
- In social affairs, the legal system, the educational system, the health system, and the welfare system.

In each of these areas, concentration should be not on current problems, but rather on their fundamental causes. Instead of attacking each problem incrementally, we need to ask such questions as:

- What was the rationale for the existing system?
- Does the system still work?
- If not, what changes in the system are in order?

Although major structural changes in our economy and society can be introduced only gradually--and only through interactions among all levels of government, business, and the American public--strong, consistent Presidential leadership is crucial. If a national consensus is to emerge,

the principles, objectives, and rationale for new policies need to be clearly and repeatedly stressed.

Economic Policy

In economic policy, there should be a renewed commitment to the long-term objectives of President Reagan's 1981 program. Neither the impressive economic recovery nor the emergence of large federal government deficits should divert us from those objectives, which are to restructure the tax system and to reorganize federal spending programs.

A historic opportunity exists for tax reform. No policy initiative could be of greater importance to the future health of our economy and society. Tax reform should be designed to eliminate disincentives for saving and for private initiative. Over a period of years, we should move to a system that taxes:

- Only individuals, not corporations (which are only conduits for the flow of income)
- The broadest possible income base, with significant deductions for savings
- At the flattest possible rates.

A systematic effort should be made to identify federal programs that can be handled by the private sector. In addition, basic reforms of the Congressional budget process are needed.

In other areas of economic policy, we need to:

- Continue the process of deregulation
- Continue the basic thrust of recent monetary policy, but with renewed efforts to reduce market uncertainty about the course of monetary aggregates by articulating clear, consistent rules
- Continue to reduce barriers to international trade and to stimulate U.S. private foreign investment.

In addition, initiatives are needed to facilitate the formulation and implementation of more coherent, long-term approaches to foreign economic and trade issues. There should be new mechanisms in the Executive Office of the President to organize and coordinate economic policy, in the context of both our broader foreign policy and our general economic objectives.

Social Policy

Dramatic changes in the U.S. economy and society make it necessary to reconsider how some of our social institutions work and how their operation can be improved.

Our legal system is badly in need of reform. U.S. society has become excessively litigious and judges are too involved in policy formulation. The ill effects include paralysis of government, lengthy delays in economic projects, a sapping of initiative, and a weakening of individual responsibility. Possible reforms include:

- Accelerated deregulation of the legal system, especially a drastic reduction in the number of tasks reserved for lawyers
- A substantial reduction in the load on the federal court system (finding alternatives to adversarial court processes, for example)
- A reduction in judicial policy making (reducing the use of mandatory injunctions, for example)
- Improved accountability of federal judges, through periodic reconfirmation and Congressional review.

Our welfare policy should aim at reducing welfare dependency by assessing the fundamental causes of poverty and then trying to attack

those causes. Some recommended actions include:

- Appointing a national commission to report on the quality of family life in the U.S., and to assess how such social problems as divorce, desertion, and illegitimacy can be both causes and primary manifestations of poverty
- Removing elements of the present tax code that discriminate against work and family cohesion
- Redirecting federal social research to concentrate on welfare dependency
- Upgrading the collection of statistics on poverty
- Giving more administrative flexibility to state and local welfare agencies and rewarding state and local governments that reduce dependence
- Revising policies that promote welfare dependence among mothers of very young children
- Providing incentives for adoption as a solution for out-of-wedlock pregnancies.

The quality of education badly needs to be improved. This can only be done through a national effort that involves not only teachers but also elected officials, worried parents, and

taxpayers. The administration could lead the drive for reform through such steps as:

- Focusing national discussion on what every child should learn in school
- Trying to improve measures of educational performance
- Improving the quality of teachers not only through higher pay but also through such steps as increasing the number of year-round teaching contracts and liberalizing teacher certification requirements to place greater stress on quality and less on formal preparation in "education."

To moderate the soaring cost of health care, recent efforts to reform the health care system need to be continued. Competition in health care delivery must be encouraged, and individuals must be given incentives to use less costly health care services.

The U.S. must prepare for rapid changes in the structure of the economy and in the kinds of jobs and skills that will be needed. Although the growth of our labor force is slowing, many Americans face great difficulty in finding jobs because their academic and vocational skills are deficient and their functional skills are obsolete. A public and private training policy is needed for:

- Hard-core unemployed youth-- This will require federal financing.
- Functional illiterates--Both public and private volunteer efforts will be needed.
- Entry-level workers -- These would be helped best by improving the entire vocational, technical, and academic educational system.
- Retraining of displaced workers--Such programs could be improved by providing tax incentives to business for hiring and training, and by guaranteeing assistance for relocation.

With respect to illegal immigration, employer sanctions should not be adopted because they are potentially discriminatory. And amnesties would reward those who have entered illegally while penalizing those who seek legal admission. Instead, efforts should be made to expand the border patrol, to improve enforcement of existing labor legislation, to reduce the access of illegal immigrants to social-transfer payments, and to increase emphasis on citizenship requirements.

FOREIGN POLICY AND NATIONAL SECURITY

In foreign policy, the administration should clearly enunciate its

fundamental objective: to promote the expansion of democratic political values throughout the world. This positive focus--rather than containment of communism or timid defense of the status quo--should be the rationale for U.S. actions and would improve the image foreigners have of the U.S. These two initiatives would further the fundamental objective:

- Reassertion of Presidential authority vis-a-vis Congress in the formulation and implementation of foreign policy
- Reestablishment of the National Security Council as the clearing house for foreign policy decision making.

In return for soliciting Congressional input in the early stages of policy formulation, the President should receive greater Congressional cooperation and support in the execution of that policy. Forceful and continuous articulation of his policies to the public is the surest way to assert this Presidential prerogative. A low-profile, independent NSC staff that coordinates decision making and monitors its implementation would do much to ensure that the administration speaks with a clear, single voice to the public and to the world.

In accordance with the general foreign policy objective, our economic

and military policies should bolster democratic governments in such areas as Central America. U.S. economic aid should promote the development of stable private markets, while U.S. security assistance should give democratic governments the means to defend their national sovereignty from subversion and external aggression.

Success in foreign policy depends critically on the maintenance of a strong strategic deterrent. Our deterrent would be enhanced, not weakened, by pursuing the Strategic Defense Initiative because it will give our strategic weapons a better chance of surviving a first strike. In addition, SDI reinforces our nuclear guarantee of Western Europe, and may spur the Soviets to negotiate arms control agreements.

To enhance the military contribution to national security also requires initiatives that promote a cost-effective defense. Such initiatives include:

- More continuity in the top-level management of new weapon systems, more realistic testing of new weapons design in the preproduction stages, use of warranties where appropriate, and cost sharing by contractors when design defects lead to repairs and revisions.

-
- Maintaining the maximum degree of competition in the defense industry, through continued efforts to increase the number of contracts let on a competitive bid basis.
 - Whenever possible, shifting from cost-plus contracts to fixed-

price contracts. As a quid pro quo, the government should shift from a single-year to multi-year contracts, to enhance long-term planning by industry. Incentive clauses should be added to contracts, to reward contractors who deliver ahead of schedule and below contracted price.

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I. THE ROLE OF GOVERNMENT IN A FREE SOCIETY

Recent United States history has seen an unprecedented expansion in the role and scope of government and, correspondingly, in its economic power. While the more traditional protective and adjudicative roles of government have remained fairly constant, its involvement with the demands of its many constituencies has expanded dramatically: Total federal, state, and local government spending has risen from 21 percent of the U.S. gross national product in 1950 to more than 35 percent in 1983; transfer payments to individuals alone have risen more than 400 percent since 1960, even after adjusting for inflation.

This trend toward ever greater government spending suggests that as a country we are increasingly accepting the idea that a stronger, better-financed central government is the best vehicle for solving individual problems.

Our founding fathers were skeptical of this view. They were fearful of a concentration of power--economic or political--in the hands of any central authority. America's political philosophy is grounded in a belief in the dignity of the individual, in his ability to choose his own goals and be responsible for those choices. Americans have traditionally preferred to choose for themselves rather

than have choice forced upon them by others--no matter how well-meaning the others might be. Justice Louis Brandeis eloquently expressed this in 1928:

Experience should teach us to be the most on our guard to protect liberty when the government's purposes are beneficial. Men born to freedom are naturally alert to repel invasion of their liberty by evil-minded rulers. The greater dangers lurk in insidious encroachment by men of zeal, all well-meaning but without understanding.

Our founding fathers recognized that any exercise of government power tends to restrict individual freedom and opportunity. The more power in government, the more restrictions upon individuals. Indeed, the common thread in the constitutional revolutions throughout the Western world during the Eighteenth Century was the desire of men to limit government and make it responsive to the will of the people. These beliefs led to our constitutional democracy and Bill of Rights.

We believe that the increased concentration of power in government at the expense of the private sector is a worrisome trend. A market-based system--one based upon voluntary

exchange between individuals, or a positive-sum exchange where both sides independently weigh costs and benefits--is not just one alternative among alternative economic systems that are compatible over time with a truly democratic political system. A market-based system is the *only* economic system compatible with a "free" political system. A decline in the former threatens the latter.

A market-based system limits the political power of government by reducing the area over which political power can be exercised; it thus becomes an important check on the undue concentration of political power. A "free" political system cannot exist without a vigorous market-based economic system.

The extension of government power and resources into all activities of human conduct is a particularly disturbing trend because it weakens the traditional Western emphasis on individual responsibility and replaces it with the notion that individuals (and families) need not be responsible for their own decisions. Perhaps the rationale behind the increased role of government in our lives is that we are increasingly facing problems that are, by and large, impossible for individuals to deal with alone. Increased demands are therefore made upon the state, and eventually there is the expectation that the state will meet them. One of the consequences of this development is that government too often tries to supplant

the family rather than defend and protect it.

The next agenda should recognize that it is the family--not the government or the state--that is the traditional nucleus of our society. People who are raising children responsibly are serving the future. Their role should be recognized--in the tax code, in educational policies and practices, in preventing crime, and in halting welfare dependency. A new social policy, centered on families, can be a proud accomplishment of the next agenda.

There are, however, clearly duties and responsibilities that are properly left for government. Yet as government seeks to carry out even its legitimate mandate efficiently, a number of troubling developments hamper it.

Some of these developments have been spawned by the increasing size and complexity of government itself. Many special interests, for example, have found it necessary to form coalitions to gain access to and exert influence on the political process. In some ways this has been a positive development in that it brings all points of view into the public policy debate. But, almost by definition, special interest groups are more concerned with their own causes than with the costs that may be imposed by their demands. If it is in their economic interest to regulate prices, control output, or lobby the public sector on their own behalf, they will

do so even if it reduces the economic efficiency and productivity of society as a whole.

We are concerned that a condition may be setting in whereby increasingly powerful and specialized interests virtually "wage war" to protect and enhance their own lot at the expense of overall economic efficiency, and where bitter political divisions are becoming commonplace. This tendency can and should be reduced. We believe individual freedoms--consistent with societal objectives--can be maximized by reducing reliance on government. An important step in this direction is the continued deregulation of the economy.

We are also concerned about the shift in governmental power away from state and local governments toward the federal government. At the same time, we fear that states may impose some of the regulations that the federal government has done away with, creating 50 laws instead of one (e.g., on the environment). Primarily, however, we believe decentralized responsibility avoids the dangers of a concentration of power, offers more choices, and is more conducive to individual freedoms. It sparks competition and improves economic efficiency. It fosters innovation and generally improves accountability.

Another significant concern is our belief that the allocation of power and responsibility between the executive

and legislative branches of government has swung too far toward the legislative. We do not think it is correct to conclude from this that the public fears strong Presidential leadership and prefers instead an ongoing and constant Congressional challenge to the executive branch. Our democracy is vigorous enough to live with strong leadership as well as to discipline that leadership in the event it fails to carry out the public will. Paralysis and impasse are not the necessary price of checks and balances in a democratic system.

The most dramatic and damaging constraint on the President's power is the increased willingness of Congress to erect barriers to the conduct of foreign policy. At times, the new consultative, reporting, acquiescence, and disapproval powers have put Congress in the middle of the day-to-day conduct of foreign relations. At times, the nation seems to have several, sometimes conflicting, foreign policy agendas and objectives: those of the President, those of the various House and Senate committees involved in foreign relations (budget and appropriations, intelligence, armed services and general oversight), and those of the major departments of government that often work at odds with the President.

The President is the constitutional leader of the nation, the only one with a national constituency. Party authority and discipline, however, have become highly fragmented. Increasingly a President must govern

without the cooperation of Congress, using the discretion of the Chief Executive until it is time to seek funds through the budget process. This impasse makes it very difficult for the President to implement his programs, with the result that many are not as coherent as they should be. One consequence is that the American people are presented with bits and pieces of policy initiatives and are deprived of a chance to judge a distinct program put into practice.

Congress alone is not at fault. Much greater involvement of the judicial system in many areas of American life has also contributed to impasse and division in our political process. Indeed, over-litigating private and public matters is a trait of

our times that creates cynicism, a decline in comity, and the destruction of wealth.

Clearly, the legitimate roles of Congress and the courts must in no way be diminished. But the next agenda must also include an effort to strengthen Presidential authority and responsibility. The President must be seen to exert decisive and coherent leadership both within the executive branch of the government and in his communications with the American people.

With these thoughts in mind, we offer the following recommendations in domestic and international economic policy, foreign policy, and social policy, broadly defined.

II. DOMESTIC AND INTERNATIONAL ECONOMIC POLICY

ECONOMIC POLICY OBJECTIVES: SHORT- TERM AND LONG-RANGE

The Reagan administration came into office with a clearly articulated set of economic policy objectives, summarized in the President's words as "Give the economy back to the American people." The central goal was to reduce the federal government's presence and intervention in American economic life, specifically to facilitate more effective performance of the market system by reducing the federal government's distortions of market price signals.

Achieving this central, long-term goal called for not merely shrinking the size of the federal government, but also for changing what it does and how it does it. The administration's underlying conviction was that the private market system affords the optimum social organization for pursuing the fundamental goals of economic activity. These goals, common to virtually all people, include a rising living standard, expanding opportunities for gratifying and financially rewarding employment, and achieving a stable level of prices. The key to achieving them is to make the most efficient use of available production capacity. This, in turn, requires the fullest and most accurate

information about the rewards and costs of alternative strategies, including impediments to achieving maximum output.

The market mechanism performs this critical function of allocating production resources far better than any other system. To be sure, there are many instances of market imperfection or failure, and in some cases there are opportunities for skillful and appropriately designed government intervention to improve market performance. But the basic persuasion of the first Reagan administration--that the magnitude and scope of government intervention far exceeds that needed to improve market performance--seems correct, as does its corollary, that the nature of the intervention more often than not impairs rather than improves the market's operations.

1981 Initiatives

The 1981 Reagan program accordingly called for a fundamental and long-term reorientation of public economic policy. It contained four principal components:

1. *To slow the rate of increase in total federal spending, while increasing the rate of defense spending--thereby reducing the federal government's demands on the economy and*

insisting on more economical government use of resources--All federal spending programs were to be evaluated to identify their objectives and to determine whether these were both appropriate and appropriately pursued. They were also to be reviewed to determine how large, in terms of dollars, each program should be.

2. To revise the federal tax system to reduce, if not completely eliminate, its bias against saving, capital formation, and individual efforts in the marketplace--While not disregarding considerations of simplicity and fairness, the objective was to achieve neutrality in the tax system--i.e., the least possible tax distortion of the market's relative cost and price signals and thus the least damaging effects on private initiatives and economic growth. Administration recommendations included an across-the-board, equal percentage reduction in individual marginal tax rates and replacement of the existing depreciation system with an accelerated cost recovery system.

3. To reform the federal government's regulatory system--The aim was to devise regulatory methods to remedy market imperfections, not to constrain or to frustrate market outcomes.

4. To revise the conduct of monetary policy by the Board of Governors of the Federal Reserve System by reducing both the rate of increase in the growth of the basic monetary aggregates--the monetary base and the

money supply--and the volatility of that growth--The purpose was to shrink the extraordinary inflation rate and the uncertainty in financial markets generated by unpredictable, frequent, and substantial changes in the rate of change in the money aggregates. Reducing the volatility would permit financial markets to perform more efficiently their essential functions of measuring the costs and rewards of saving and mobilizing that saving for productive uses. In addition, removing unwarranted regulatory constraints on financial institutions would permit them to function more efficiently.

This 1981 economic program was primarily domestic in its focus, but it also had clear implications for foreign economic policy. The redirections were intended to reduce the federal government's presence in foreign trade and to free up markets abroad and at home. For example:

- Except in emergency circumstances, the Treasury and the Federal Reserve were not to intervene in foreign exchange markets.
- Economic aid to other nations was to be directed increasingly through private sector vehicles.
- Economic development programs were to rely more on private sector institutions and market clues than on the directives of public international financial institutions.

To recapitulate, the overall thrust of the economic program was to back the federal government away from specific market interventions to allow the market system to operate more effectively.

1985 Initiatives

Should the policy goals articulated early in 1981 be those for the next administration? They should be. The market orientation of public economic policy is as valid today as it was in 1981. A continuation of this thrust is urgently required for effectively dealing with the problems that the U.S. economy is likely to confront during the remainder of this century.

The current inflation rate is far lower than when President Reagan was inaugurated, but no natural law assures that it will remain so. Thus we continue to confront the problem of establishing a monetary policy that will consistently avoid excessively rapid monetary growth and its eventual inflationary consequences. Similarly, we continue the quest for a monetary policy that is predictable and that provides for steady, moderate growth in monetary aggregates.

While some progress was made in the Economic Recovery Tax Act (ERTA) of 1981 toward reducing the bias in the tax system (against work, saving, and capital formation), the 1982 and 1984 tax legislation moved away from this goal. It is time to renew progress toward a neutral tax

system that does not impose such costs on our economy as lower economic growth, lower employment, and higher interest rates.

The problems of containing accelerating growth in federal government spending are no less severe today than four years ago, although large budget deficits have served to moderate the pace to some degree. There is, however, no guarantee that these deficits will continue to perform that function, especially since great efforts are being made to reduce them.

Recasting regulatory policy to permit more successful pursuit of the legitimate goals of regulation while reducing its disincentives to economic progress is still as urgently required today as it was four years ago.

Similarly, no less now than in 1980, we need new strategies to expand our foreign trade and establish constructive economic relationships with developing countries, primarily through private sector initiatives. These strategies must be consistent with U.S. foreign policy objectives but should otherwise minimize reliance on government support--on protectionism or subsidies--lest we lose the basic benefits of international trade. Above all, we will have to continue to minimize institutional and regulatory impediments to flexibility in private markets. This vital sector must be in a better position to take advantage of changes in costs and demands.

Maintaining a public policy environment wherein economic growth is not inhibited has always been a serious challenge. It will become even more severe when the pace of economic expansion slows as the economy approaches a new and higher long-term growth path. The principal consequences of failing to meet that challenge will be slower growth in productivity, slower gains in employment, and slower increases in real wage rates.

The next administration can choose an activist, ad hoc, problem-by-problem approach to dealing with these challenges or it can choose a systematic shift toward greater reliance on free-market strategies. The 1981 Reagan program exemplifies the latter approach; we believe it warrants even more consistent application than it has so far received.

THE NEXT ECONOMIC POLICY AGENDA

A strong, productive economy is a prerequisite for fulfilling the many domestic and international objectives of the United States, including the maintenance of a sound national defense. Looking ahead, it is likely that the pace of economic expansion will begin to slow, as will the brisk gains in employment and productivity realized during the recovery. These developments should not be interpreted as a failure of public economic policies, but rather as the occasion for facilitating prompt and efficient

market adjustments to economic developments both at home and abroad.

Fiscal Policy

Perhaps the greatest economic policy challenge the next administration will face will be to reestablish appropriate priorities in fiscal and budget policy.

Since the latter part of 1981, the driving force in federal fiscal policy has been the deficit. In fact, it has been the focus of every aspect of federal finance. Basic considerations of tax and spending policies have had to take second place, at best, in determining budget actions, tax legislation, and other elements of economic policy. Indeed, constructive developments in other areas, including foreign policy and defense, have been frustrated by fears about budget deficits.

The principal consequence of this singular concentration is that the fiscal policy thrust of the first eight months of 1981, best represented by ERTA, has been greatly blunted. If those objectives and priorities are still appropriate, that thrust must be regained.

The urgency of refocusing on the original objectives should not be obscured by the impressive economic recovery to date. One of the most important aspects of the 1981 initiatives--embraced by Democrats and Republicans alike--was the focus on long-run consequences. There was

a concerted effort to develop policies and institutional arrangements that would least impede the market's efficiency in terms of providing for long-run consequences. There was noninflationary growth and rising living standards. The current economic recovery should not eliminate or distort this long-run orientation. After all, the 1980-81 insistence on long-term considerations was not deflected by the short-term fine-tuning of the prolonged recession that began late in 1978.

The policy focus of early 1981 cannot be restored without a drastic reordering of policy concerns. As long as the reduction of federal budget deficits is the primary focus, other fundamental issues of fiscal policy are not being properly addressed. The budget deficits must be downplayed if the Congress and the administration are to shift their attention to two separate, principal areas: (1) restructuring the tax system and (2) reorganizing federal spending programs.

Tax Policy

Tax reforms should aim at achieving the greatest possible degree of tax neutrality. The traditional income tax exerts a strong bias against saving and capital formation in favor of current consumption, against productive personal effort in the market system, and in favor of a whole range of activities called

"leisure." Eliminating this bias entirely may not be possible, but it should be possible to reduce it considerably. This requires (1) taking current saving out of the tax base and (2) the flattest possible marginal rate structure. If graduation of effective tax rates is deemed to be essential, we should rely on the zero-rate bracket and personal exemptions for this purpose.

The modest progress achieved by ERTA should be enhanced by moving, over a period of years, to a new income tax system. Its fundamental attributes are that it should be imposed:

- Only on individuals, recognizing that corporations do not pay taxes but act only as a conduit for collecting taxes from the providers of the labor and capital service that they employ
- On the broadest possible income base, with the broadest, most inclusive deductions for current saving and the most complete inclusion of returns on that saving
- At the lowest, flattest possible rates, using personal exemptions and the zero-rate bracket to provide such progression in effective rates as may be desired, recognizing that statutory or marginal rate graduation imposes punitive excises on productivity-increasing activities

- On the largest possible number of people in such a way as to maximize their consciousness of their tax bills

There is an historic opportunity at this time for tax simplification and reform. Tax reforms should remain separate from budgetary issues to ensure that tax policy is formulated and evaluated on its own merits. These efforts can provide the cornerstone for what could prove to be the greatest legacy of the Reagan administration's second term--sustained economic growth.

Tax increases to reduce the deficit do so at the cost of at least equal reductions in private sector saving. Any politically acceptable increase is therefore likely to accentuate the bias against private saving and imperil the economy's long-term growth and efficient operation.

Spending and Budget Policy

The focus of spending policy must be on reforming and controlling government spending, specifically on evaluating the objectives, content, and methods of federal programs. Particular attention should be given to finding private-sector alternatives: for example, a phased-in, private-sector alternative to social security that is specified in law and retains the portability of the current system (but reduces its demands on the government). Similarly, unemployment insurance (with some minimum and mandatory coverage requirements) is a candidate for gradual transfer to the private sector.

Privatization clearly needs to take place over an extended time, and with specified standards and safeguards assured. Once in place, it could generate major reductions in important government spending programs.

To facilitate these and other reforms, the President should be able to use line-item veto power in appropriation bills. In addition, an effective and workable balanced budget amendment to the Constitution should be considered. Both these initiatives would underline the urgency of spending reforms, but in all likelihood, major revisions in existing Congressional budget procedures will also be necessary (for example, reworking the 1974 Act). To date, the budget process has served primarily to justify spending increases and deficits, not to provide well conceived and carefully constructed spending programs.

Regulatory Policy-- Depository Institutions

Substantial and important reforms have been made in the regulation of financial institutions, communications, and transportation. Legislation passed in 1978, 1980, and 1982, for example, has greatly increased competition among depository institutions, benefiting both borrowers and depositors. But much remains to be done:

- Further diversification and competition, both geographically and in services offered, is

important, and we urge the administration to support it.

- Federal insurance of deposits at flat-rate premiums needs to be replaced by an insurance system that reflects accurately the riskiness of the institutions' investment portfolios.

A situation now exists in which banks' investment policies are inadequately constrained by considerations of the riskiness of their investments, because the risk is not borne by the investor but by the federal insurance funds. Both the Congress and the regulators recognized this problem following passage of the Garn-St. Germaine Depository Institutions Deregulation Act in 1982, but have done nothing to resolve it. The remedy should come via a restoration of market discipline rather than by reversing any of the accomplishments of the last several years.

The current thrust toward reregulation--of depository institutions and other markets and sectors--must be resisted by the next administration. Deregulation and regulatory reform should instead be given new life by extending the free-market approach throughout the economy.

Monetary Policy

The monetary policy prescription of early 1981 remains valid today. Its effectiveness is confirmed by the dramatic decrease in the inflation

rate since 1980--one of the most favorable economic developments to date. This must not be jeopardized by renewing an untoward increase in the money stock.

What is needed, above all, is the articulation of some consistent rules to guide the Federal Reserve's actions concerning monetary aggregates and their application. The rules should provide the greatest possible certainty as to what actions the Federal Reserve will take; they should, in other words, minimize discretionary actions.

The Federal Reserve must discard the notion that it bears responsibility for determining either real or nominal GNP, either in the short run or over the long term. As long as the Federal Reserve is to continue to perform central bank functions, its guiding principle should be to do so in a way that minimizes market uncertainty about monetary aggregates.

International Economic Policies

The next administration should promptly clarify its objectives in international economic affairs, as well as the means for their attainment. The strategy of the Reagan administration ostensibly was to emphasize the contribution of the private sector to economic development in Third World countries, but the punitive tax legislation in 1982's Tax Equity and Fiscal Responsibility Act (TEFRA) was a serious step

backward in this respect. Coming at the same time that the Caribbean Basin Initiative called for private-sector initiative, TEFRA cast serious doubts on the consistency and firmness of purpose in relying more heavily on private-sector initiatives. Reinvigoration of the private-sector approach is called for through extension of the territoriality concept of taxation inherent in the corporate provisions of the Internal Revenue Code. Grenada, to cite one example, offers the possibility of a successful implementation of this approach.

A corollary is to exert every effort to shift the focus of the International Monetary Fund away from the restrictive austerity programs it has emphasized toward growth-promoting fiscal and monetary policies in developing countries. Service of foreign debts by these nations will be more burdensome under slower-growth regimes.

By the same token, if these nations are to accelerate their development, they will need freer access to foreign markets for their exports. A free, private-market reorientation of our international economic policies requires vigorous pursuit of freer, more open markets everywhere. The United States should use its considerable leverage in international forums to pursue this objective.

A collateral benefit of opening U.S. markets is the consequent pressure to improve our competitive-

ness in advancing our technology (while gaining the benefits of other nations' technological advances) and pressure to restrain unrealistic wage demands by American workers.

A concomitant of this widespread, private-sector free-market approach must be to enhance the competitiveness of U.S. firms abroad. Institutional barriers, in the tax code and elsewhere, should not be allowed to impede effective participation by U.S. firms in foreign markets; trade-restraining practices of our trading partners should be vigorously opposed.

There is an overriding need for a clearly developed and articulated comprehensive foreign economic and trade policy. Present ad hoc approaches result in attention being given to specific issues (e.g., reducing trade barriers to U.S. exports of beef, citrus, and tobacco) that do not represent key areas of U.S. foreign economic activity, now or in the future. The current fragmented system needs to be rationalized or replaced by mechanisms that promote the formulation of coherent, long-term, and thoughtful approaches to foreign economic and trade issues.

The U.S. should continue efforts to liberalize trade, domestically and internationally. Continued economic development depends on it. Subsidies and barriers, if used at all, should only be used purposefully--that is, in pursuit of specific foreign policy and national security objectives. A next

round of trade negotiations should be held to consider international agreements on capital flows, capital investments, trade in services, trade in agriculture, trade with non-market economies, and protection of patents, trademarks, and copyrights, among other things.

In addition, a broker is needed within the Executive Office of the President to reconcile overlapping defense, foreign, economic, and trade areas. The broker role would play an important coordination function in the government, not a planning function. It should provide for the institutionalization of an economic policy apparatus that integrates domestic and international considerations, eliminates redundancies, and has sufficient authority to do the job.

In sum, public economic policies appropriate for the remainder of this decade and beyond seem to call for the following:

1. *A monetary policy that provides a steady, moderate rate of growth in the monetary aggregates over which the Federal Reserve has direct control, principally the monetary base*

2. *A focus of fiscal policies on improving the tax structure and spending programs, rather than on deficits*

3. *A spending policy that focuses on program objectives and content, and that fosters private sector alternatives to federal programs*

4. *A tax policy that gives far greater emphasis to the elimination of the excise effects of taxes (i.e., their distortion of the relative price signals the market provides) and that rejects income redistribution and short-run economic stabilization as neither desirable nor attainable policy objectives*

5. *A regulatory policy that seeks to pursue its objectives by improving market performance rather than trying to override and replace market outcomes with government fiat*

6. *An international economic policy that seeks to open markets in every nation, avoids either subsidies or penalties as instruments of trade policy, relies primarily on the private-market approach to promoting economic development in Third World nations, and attempts to integrate our foreign economic policy more effectively with our foreign political policy.*

III. U.S. FOREIGN POLICY AND NATIONAL SECURITY

INTRODUCTION

The new administration must articulate a clear and coherent foreign policy agenda by addressing the various national and international factors that influence the conduct of international affairs. The administration must present its case to, and garner support from, the general public, their representatives in the Congress, and U.S. allies abroad.

Four broad principles should serve as the cornerstone of our foreign policy efforts:

1. *A philosophical commitment to playing a leadership role in the world--with full recognition of the obligations and difficulties that leadership brings.*

The United States must remain vigorous in its commitment to the continued development of free political institutions and market-based economic organizations throughout the world. Only by clearly and affirmatively positing freedom, and expounding democratic political values by nations as well as individuals, can the U.S. be the leader that others can look to for support and direction.

Since the end of the Second World War, among the most significant changes in the foreign policy challenges facing the United States have been the increases in Soviet military capabilities (in strategic as well as conventional forces) and in Soviet-American competition for influence in developing countries. But there has also been a significant change in the allocation of economic power, in part because of postwar U.S. policies that assisted the reconstruction of wartime allies and enemies alike. As a result, the world has witnessed the most dramatic period of economic growth in history. The United States remains the single largest economy in the world today; its economic performance in the future will greatly influence the degree to which economic competition occurs, and whether it takes place in an expanding or a stagnant world economy.

At the same time, the ever-increasing integration of the world economy requires the U.S. to reassess its goals in light of the achievements of others. If the U.S. is to provide the leadership that no other nation is capable of providing, the administration must review the various domestic factors that constrain it from

exercising leadership, even over its own foreign policy. For example:

- The economic obstacles that stand in the way of a sustained economic recovery, as discussed earlier
- Its institutional capacity to deal with foreign policy and defense issues--both within the federal government and in terms of the increasingly prominent role of Congress
- Its capacity of seizing the diplomatic initiative in international affairs through expanded public diplomacy.

Neither the containment of forces promoting totalitarianism nor the timid defense of the existing status quo will stimulate broad support for foreign policy. For this, a more visible and dynamic effort is necessary.

2. The recognition that effective security needs an energetic alliance system capable of dissuading the Soviet Union and its allies from contemplating military action against the rest of the world.

The alliance systems, from NATO to ANZUS and numerous bilateral security treaties, represent mutually beneficial relationships. The administration should refocus attention on the fundamental point that neither the United States nor its allies would derive any benefits from adopting an isolationist or unilateralist posture.

There is clearly a tendency on the part of U.S. allies to delay the assumption of additional burdens--even for the sake of common interests--because of domestic economic and political problems.

In its own policy deliberations, the administration should face this central tension of alliances: that the U.S. as well as its allies are trying to have it all ways. We would like our allies to assume a greater share of the common burden, but as the single most important military and economic power we would also like to make various decisions on their behalf. The allies, on the other hand, recognize full well their dependence on the U.S. for their security vis-a-vis the Soviet Union, but they seem to believe that the Soviet threat is significant and lasting enough to give the U.S. its own reasons for maintaining existing alliances without significantly increased contributions from them. In fact, they seem to feel that assuming a greater share of "common burdens" would not necessarily lead to any proportionate increase in benefits to them.

At the least, American leaders must strike a clearer balance between these interpretations and perceptions and dispel the notion that the United States alone provides security for other nations. Both the U.S. and its allies must strengthen collaborative efforts to defend their common interests in Europe and other parts of the world.

3. *In the area of strategic policy, the President must reassert the necessity for maintaining America's deterrent capability in a changing strategic environment.*

Unilateral restraint by the United States, in either upgrading existing strategic forces or developing new defensive systems, can only be counter-productive in dealing with the Soviet Union. Only when the United States and its allies present the Soviets with a forceful and united strategic position can successful negotiations toward mutual and verifiable reduction in arms proceed.

4. *The United States must give priority attention to certain regional areas, particularly Central America, where geographic, economic, political, and military challenges combine.*

If the U.S. cannot help foster a secure arena of democratic development on its doorstep in Central America, its attempts to deal with similar challenges in more distant areas of the world will be impaired.

CONSTRAINTS TO A COHERENT FOREIGN POLICY

The Executive and the Congress

A certain amount of friction has always existed between the Congress and the executive branch over issues of foreign policy. But during the past

decade, particularly since the Vietnam era, the conflict has had an extraordinarily debilitating effect. Its range has broadened to include almost all areas of defense, intelligence, and foreign policy. Its character has changed, so that even when decisions are ratified by Congress, restrictive conditions often compromise their effectiveness. In addition, new authorization or appropriations bills several months later frequently rekindle the same controversies.

In 1984 the executive-legislative friction was apparent in endless impasses involving the defense budget, in general, and recurrent funding constraints on El Salvador and the acquisition of the MX missile, in particular.

The problem can be characterized as the starvation of policy. Some members of Congress view their role as primarily one of obstructionism, thwarting policies they disagree with. But their methods of compromise and constraint, even on policies they approve, can also conflict with the articulation of a coherent and consistent foreign and defense policy.

The executive branch of government has undoubtedly contributed to this confrontational process by failing to provide Congress with a coordinated approach to policy initiatives. There is no systematic communication between the White House, State Department, Defense Department, and the Agency for International

Development (AID) and other relevant agencies. Moreover, those sections of executive departments responsible for Congressional relations have had neither the status nor the expertise to effectively deal with Congress.

During the initial discussion phases of policy development, the administration must more vigorously solicit Congressional input; on the other hand, once decisions are made and ratified by the Congress in major authorization bills, the administration should be allowed to carry out its program or policy, without subsequent interferences. The start-and-stop method of running defense and foreign policy prevents an honest evaluation of programs by either proponents or opponents, each of whom blames the others for any subsequent failures or inadequacies.

Nothing is more important to the effective execution of American foreign policy than the clear, forceful, and continuous articulation of its goals and objectives--by the President himself as well as by key administration officials. In-fighting in the executive branch of government must be curtailed through decisive Presidential leadership; all Presidential appointees must responsibly represent his views. Any delegation of authority to departmental heads should not deteriorate into an abdication of Presidential leadership of foreign policy.

We urge the President to boldly expand his efforts to communicate with the people in this crucial area.

Reforms Within the Executive Branch

If the United States government is to be understood by adversary and ally alike, it must speak with a single voice--that of the President--in foreign policy. The executive branch must be preeminent, as explicitly provided for in the United States Constitution, even as Congress plays a major role in either ratifying or rejecting major foreign policy initiatives through funding and other actions on specific legislation.

In each of the last several administrations, conflicts have arisen between at least two or more of the four key foreign policy departments of government: State, Defense, the CIA, and the National Security Council (NSC). Conflicts have erupted over such broad issues as U.S.-Soviet relations, Middle East policy, and the war in Central America, as well as over a variety of narrower issues. The result has been at least the appearance of incoherence. Many of these conflicts were initially attributed to personalities, but even when the personalities changed, significant conflicts persisted.

The time has come to re-examine the structure of the foreign policy apparatus. The present structure was

created in 1947 in legislation that established the Department of Defense, the CIA, and the NSC. With nearly four decades of experience, and after the exponential growth of U.S. involvement in overseas activities, the system should be reexamined to determine whether changes are necessary to cope with the more varied demands placed upon it.

The role of each foreign policy department in government is partly a function of personal Presidential style, but institutional lines of authority between them nonetheless need to be more clearly defined. The Murphy Commission in 1975 and the Odeen Report in 1979 both suggested numerous changes, particularly in the role of the NSC and the State Department. Overall, a great need exists to make the entire foreign policy apparatus operate more efficiently.

We recommend that existing structures be reformed and streamlined. This would mean re-establishing the National Security Council as the foreign policy clearinghouse, thereby bringing the widest range of information and analysis to the President and then coordinating decisions and monitoring their implementation. The public role of the NSC would necessarily be small so that the NSC advisor and his staff could be honest brokers of policy between other departments. To

effectively carry out the broker role, NSC staff must not principally be drawn from other departments of government and constituent organizations. Rather, more top level Presidential appointees to the NSC should come from outside the government, and all NSC analysts must be as independent and objective as possible, regardless of their institutional loyalties.

The State Department should have the primary role in recommending foreign policy options to the President and then representing U.S. foreign policy (on behalf of the President) to the public and the Congress. To do this, key officials, particularly the Secretary, must command the respect and share the foreign policy agenda of the President. Similar appointments should be made to key policy positions at the Pentagon.

Different views on foreign policy from the Defense, State, Treasury, Commerce, and Agriculture Departments, and the CIA should all be channeled through the NSC apparatus. It is then up to the appropriate department to implement decisions when they are reached. Prescriptions are simple to state; they are much harder to carry out, and can only be effective with persistent, diligent leadership from the President himself and from top White House staff personnel.

MAINTAINING NATIONAL SECURITY

Deterrence and Arms Control

Political pressure mounted during the 1984 elections on behalf of talks on strategic and intermediate nuclear weapons. This came in the wake of Congressional pressure to link specific defense appropriations to the resumption of talks with the Soviet Union. Rarely, however, does anyone in Congress raise the issue of the ultimate purpose of arms control talks--to contribute to international stability and to enhance international security.

Negotiations with the Soviet Union must pursue these objectives, even if they aren't immediately forthcoming. Salt I did not make the world safe from the threat of nuclear weapons; some even argue that it provided the catalyst for a Soviet "leap forward." Consequently, it is imperative that the negotiating process does not create false expectations. Pressure to "simply reach agreements" has led in the past to the adoption of treaties with dangerously ambiguous language that the Soviet Union consistently exploited to gain unilateral military advantages. Such explicit Soviet violation of previous agreements requires that any new agreement contain absolute guarantees for verification.

We believe that President Reagan's Strategic Defense Initiative (SDI) can contribute to arms reduction and to international stability, and should be pursued.

SDI's detractors argue that it is not feasible, or that it is destabilizing, or prohibitively expensive, or a combination of all three. It is up to the President to present to the public SDI's various strengths:

1. *SDI gives our weapons a chance to survive a first strike; this means that it enhances the survivability of U.S. missiles, making our deterrent capability even more credible than it is at the moment.* This is both prudent and humanitarian, neutralizing the argument that only by threatening to destroy our enemies can we maintain a credible deterrent. In addition, by reducing the effectiveness of first-strike weapons, SDI could also be used to encourage significant reductions in nuclear stockpiles.

2. *SDI is a means for reinforcing our existing nuclear guarantee to Western Europe.*

3. *SDI and arms control can be mutually supportive.* If a significant portion of our missile force is capable of surviving a first strike, the Soviet Union might be motivated to enter into serious arms control negotiations with the United States.

4. *SDI provides the public with a vision of the future in which an alternative to the arms race or nuclear blackmail is presented.* It shifts the discussion of military preparations from offensive to defensive measures.

A separate but related issue involves the development of "emerging technology" (ET), such as precision-guided munitions, to provide a theater non-nuclear deterrent. While ET cannot be a substitute for conventional weapons (e.g., bombs and mortars), it does hold out the promise of neutralizing a Warsaw Pact attack on Western Europe, for example, without complete reliance on nuclear weapons. It also may be a partial solution to NATO's inferior manpower position vis-a-vis the Warsaw Pact.

Technology cannot determine doctrine but it can enhance it. Precision-guided munitions give the doctrine of "flexible response" real meaning by providing a credible range of alternative responses to differing threats posed by Warsaw Pact forces. Without precision-guided munitions, we have little flexibility to respond to a conventional attack and would likely have to rely on tactical nuclear weapons.

One final and extremely important aspect of maintaining effective security in a time of increasing competition for resources

is the necessity for a highly cost-effective defense.

Principles of a Cost-Effective Defense

During President Reagan's first term much was done to improve our nation's combat readiness, weapons systems, and the morale of the armed services. Less recognized is the importance of improving military procurement practices and increasing competition among the suppliers. These initiatives must be continued and expanded, along with other measures to help insure continued movement towards a cost effective defense. Our suggestions include the following:

1. *The U.S. defense effort should be the servant of our foreign policy. Our weapons acquisition program should be the servant of our defense effort.*

2. *The U.S. must maintain the nuclear capability necessary to deter nuclear attack, and our conventional capability must enable us to apply military force in cases where this is the only means of carrying out U.S. policy.*

3. *Just as foreign policy goals determine military missions, military missions should determine appropriate weapons design. Technical capabilities should be derived from missions and not vice versa.*

4. During the past four years much needed attention has been focused on the testing and evaluation of weapon systems. This close inspection has pointed out many failings, which the Defense Department has moved to correct. This effort must continue. We suggest more continuity in top-level project management, more realistic testing of new weapons design in the preproduction stages, use of warranties where appropriate, and cost sharing by contractors when repairs and revisions are required due to design defects.

5. The U.S. should maintain the maximum degree of competitive free enterprise in the defense industry. This policy requires a continuation of the present effort to increase the number of contracts let on a competitive bid basis.

6. Whenever possible, we should shift from "cost-plus" contracts, which insulate industry from market economics, to "fixed-price" contracts, which seek to enhance economic realism in defense. As a quid pro quo for these market disciplines, government should shift from single-year to multi-year contracts to enable long-term planning by industry. Incentive clauses should be added to contracts: if contractors perform on time and under price they should be financially rewarded.

7. The U.S. must be willing to purchase military supplies and weapon systems from U.S. allies rather than U.S. suppliers when they

offer a superior mix in price and quality.

REGIONAL ISSUES

Most regions in the world at one time or another require specific attention by the U.S., including a well thought-out approach in terms of foreign policy. We focus here only on Central America--for illustrative purposes, because of the crisis nature of current problems in the region, because of the immediacy of the issues, and primarily because of its proximity to the U.S.

The Aim of a U.S. Central America Policy

The aim of U.S. Central America policy should be to bolster, economically and militarily, national and democratic movements and governments. This means casting U.S. policy in a framework larger than simply supporting "anti-communist" regimes. It means supporting local democratic groups like trade unions, private sector organizations, and trade associations. And it means finding ways of supporting the evolutionary process towards democracy in a manner that does not weaken political stability.

Human rights cannot be separated from broad-range U.S. policy objectives in Central America. The evolution toward democracy that is taking place is generally favorable to human rights and should be a major

reason for supporting legitimate democratic efforts. It is important to remember that each country in Central America has a distinct history and political tradition. The U.S. must understand that these differences may be decisive in determining how each nation finds its own path and tempo in establishing stable and representative governments, and in according proper respect to human rights.

Economic aid also must be encased in a broader rationale than just helping a government fund costly development projects and meet its balance-of-payments deficits. The aim of U.S. economic assistance should be to develop a stable and unhampered market sector, to provide long-term growth and a wider distribution of wealth.

The key to long-term growth in Central America is the development of stable and strong market sectors. Central American economies are too often victims of centralized economic programs under state control. These are inherently inefficient, wasteful, and costly to consumers. What is needed are policies encouraging private initiatives--lowering taxes, reducing state-supported competition and monopolistic practices, instituting investment incentives, and decreasing regulation of production and trade.

The establishment of stable democratic governments with sound economic structures will provide the

best bulwark to Soviet ambitions and influence in the region. U.S. security in the future will depend on Washington's ability to provide the consistent and carefully targeted assistance that enables these weak and vulnerable nations to defend their national sovereignty from subversion and external aggression.

U.S. Security Interests

Each Caribbean and Central American nation contributes to U.S. interests by being an important source of strategic and raw materials. In addition, over 50 percent of our oil imports pass through their ports and nearby sea lanes. In a major conflict in Western Europe or the Middle East, U.S. combat troops and equipment reinforcements would pass through the area.

Serious disturbances in any one country can adversely affect the entire Central American region. Threats to the security and political integrity of nations in the area indirectly threaten the United States itself. Unquestionably, U.S. interests and the security of our allies require stable trouble-free borders and unhampered access to vital sea lanes that flow into the Caribbean.

Social and economic problems in the region have been successfully exploited by revolutionary movements supported by the Soviet Union and Cuba. Soviet-sponsored military buildups in Cuba and Nicaragua and the huge transfers of sophisticated

arms to these client states have jeopardized U.S. security. The success of the Soviet-supported Sandinistas in Nicaragua has encouraged Moscow and Cuba to promote further revolution throughout the region. Should other Central American nations share the fate of Nicaragua, the nascent democratic developments will be thwarted and the United States will face a serious regional security threat for the first time. This, of course, is almost surely one of the principal objectives of Soviet strategy in the Caribbean basin: to tie up the U.S. in its backyard and thus prevent it from adequately defending Western Europe and maintaining its other global commitments.

In addition to protecting vital national security interests, the U.S. has a moral obligation--as the most powerful democratic nation in the world--to respond to the democratic aspirations that have surfaced in Central America. This imperative cannot be ignored at a time when the region is under tremendous political and economic pressures and needs all the moral support it can get.

Achieving U.S. Objectives

Support for the democratic process should include educational exchanges, scholarships, cultural programs, and regional cooperation between private-sector and labor organizations. Washington should encourage private U.S. groups to promote joint educational and business programs with Central

American counterparts, to enhance the understanding of democratic institutions and offer concrete methods for their creation and sustenance.

U.S. economic assistance programs and loans from U.S. and multilateral lending institutions should be targeted to the private sector whenever possible. Liberalized U.S. trade and investment policies would encourage greater foreign direct investment and joint ventures that would assist in badly needed capital formation.

U.S. trade policy should be viewed in the larger context of the political and economic crisis that is undermining the area's stability. U.S. trade barriers not only hurt Central American exporters but also U.S. consumers who have to pay more for protected commodities. By promoting free trade and free markets, the U.S. will go a long way toward establishing stable long-term growth in the region.

Given the large amounts of Soviet bloc arms transfers to the region in the past decade and the stated expansionist goals of Soviet client states, the U.S. must provide Central American nations with adequate military assistance. In addition to arms sales, this should include increased technical and combat training programs, enhanced cooperation among regional military forces, and greater support and commitment to multilateral pacts and organizations such as the Rio Treaty, the

Organization of American States, the Multinational Regional Defense Forces, Condeca, and so forth. The greater and more consistent U.S. power is perceived to be, the less aggressive the Soviet Union is likely to be, since it still—at least tacitly—recognizes the Western Hemisphere as beyond its sphere of influence and a high-risk area. Greater commitment to the region's defense will prompt the democratic nations of Central America to be more forthright in their condemnation of Soviet-sponsored Cuban and Nicaraguan activities. In the long run, deterrence of Soviet involvement is the key to the security of Central America and the U.S.

MAINTAINING THE DIPLOMATIC INITIATIVE

Through a broad and revised program of public diplomacy, the United States can provide a peaceful challenge to non-democratic systems in the developing world and can help foster a positive climate that cannot be easily exploited by the Soviet Union and regional powers. In his speech before the British Parliament in June 1982, President Reagan called for the promotion of democratic values throughout the world. Among the initiatives that the U.S. and its allies can usefully pursue are:

1. *The full implementation of Helsinki agreements concerning the free flow of information in Europe.* This should be pursued by calling attention to restrictive actions in in-

ternational forums, by gaining international accord to prohibit jamming, by insisting that educational and cultural exchange programs be open and reciprocal, and in other ways.

2. *The United States should use modern technology to enhance the communication capabilities of the Western world, including further modernization of the Voice of America, Radio Free Europe/Radio Liberty, and Intelsat.*

3. *The use of international television (especially the possibility of satellite broadcasting directly to homes) should be expanded as should the spread of computer-based information systems.*

4. *Through a creative use of AID and other programs, the United States and its allies can provide incentives for developing countries to adopt programs that encourage private sector productivity and economic growth.* The Western message of democracy, freedom, and a productive economy provide hope and inspiration both behind the Iron Curtain and in many other countries experiencing political or economic deprivation. Much of the Third World has learned that Soviet economic and social prescriptions compound rather than solve their problems, and it is important to encourage the Western alternative whenever possible.

How other countries perceive the U.S. and its policies can be as important as the reality. This murky

issue of "perception" has contributed to discussions with U.S. allies and enemies on issues such as burden sharing, economic policy, strategic policy, and indeed, U.S. foreign relations generally.

In foreign policy, the issue of perception is especially important. If the U.S. is to retain and enhance its leadership position in the world, and to provide the direction, peace, and

stability that it seeks, this administration must improve its ability to get its ideas heard and understood. Greater understanding does not necessarily lead to greater agreement, but at a minimum, clarity in the presentation of U.S. objectives and intentions is simply far better than any alternative. This requires that the administration think through its foreign policy goals and articulate them with a minimum of diplomatic ambiguity.

IV. THE NEED FOR A NEW SOCIAL CONTRACT

INTRODUCTION

This year marks the 50th anniversary of one of the most remarkable pieces of legislation in American history, the Social Security Act of 1935. Conceived in the midst of a great national crisis, it not only created an enduring set of programs to help support Americans during unemployment, retirement, and other times, but more importantly, it signified the willingness of the American people to involve the federal government in a wide range of social issues. In effect, the passage of the Social Security Act marked the beginning of the American "welfare state."

The "social contract" established by the Social Security Act has grown immensely, through New Deal and Fair Deal, through Great Society and New Federalism, and through other measures too numerous to mention. The "safety net" principle works, not perfectly, but well enough so that most Americans no longer fear great destitution during their lifetime. Other social programs have helped improve education, law enforcement, health care, housing, and other aspects of life. Perhaps most significantly, the once controversial Social Security Act and its offspring now have little political opposition.

This is a mixed blessing. On the one hand, it is essential for the provisions of the "social contract" to be secure and predictable. On the other, it must be a living document, adaptable to a society where the only constant is change. The pragmatic drafters of the Social Security Act would have been the first to agree; they did not regard their work as etched in stone, but expected it to be responsive to new or unanticipated circumstances. Today, such circumstances are not hard to discern.

The Social Security Act itself, as well as a number of related programs, created some of these new conditions. While they have helped prevent poverty among the elderly, they are increasingly difficult to afford. While they provide generous aid to the so-called "working poor," they have raised concerns about the possible undermining of incentives for self-support. While there has been a significant expansion of public and private insurance plans and access to medical care has improved, care has also become more costly.

The professionalization and growth of social services has, to some extent, been at the expense of important traditional institutions like the family and the church. At the same time the definition of new legal

rights has often exposed (rather than protected) particularly vulnerable segments of society, such as the mentally ill, to conditions for which they are unprepared.

Other new conditions reflect demographic or cultural changes that were not even on the horizon in 1935. At the depth of the Depression, no one would have dreamed that skilled labor might be in short supply; today, many experts predict that shortages will occur within a decade, a development that will force a reevaluation of ideas about unemployment that are centuries old. The designers of the Social Security Act assumed that most women would spend their working years at home; today, most women are (or expect to be) in the labor force. The implications of this for social policy can only barely be seen. In the 1930s, immigration into the United States was barely a trickle; today, it has become a flood, bringing with it a host of new issues that social policy must deal with.

Thus, our recommendation that it is time to rewrite some major clauses of the "social contract" is not meant as an indictment of those who have worked so hard to construct the existing programs, but is rather a recognition that American society has changed. What follows is less a comprehensive set of alternatives than an overview of some issues that seem most pressing to us. Nobody has all the answers; we are not even sure

there are answers that would be acceptable to most Americans. However, we are convinced it is important for the new administration to begin asking relevant questions and not shy away from looking at the "social contract" on the grounds that changing it is apt to be futile, controversial, or both. Such avoidance can only hurt those people who need to be helped. Of all the legacies left by the designers of the Social Security Act, perhaps the most important was their practical and experimental approach to dealing with social problems. This tradition can still serve us well.

Insofar as there is a common thread to our recommendations, it is the belief that a new "social contract" should rely more on private responsibility and less on government agencies. Unlike 50 years ago, the typical American is more prosperous, has more resources to fall back on, and is more likely to know his own needs and how to fulfill them. Moreover, encouraging individuals to look after themselves (either independently or through voluntary association with others) has, we feel, a number of salutary social consequences that impersonal, bureaucratic programs cannot come close to duplicating. We neither expect nor want the "welfare state" to wither away. What we do want, and think will serve the nation well, is a social policy that looks to all of us to help attain the common good.

REFORM OF THE LEGAL SYSTEM

The expanded role and complexity of government has given rise to a society that has become excessively litigious and a legal system that is now grossly overblown. In 1985 alone, the United States can expect nearly 15 million civil cases to be filed and more than 30,000 new lawyers to graduate from American professional schools. The ratio of lawyers to the rest of the population is probably higher here than anywhere else in the world: the U.S. has one lawyer for every 600 citizens.

Federal judges are becoming day-to-day managers and implementors of public policy. They influence how prisons, nursing homes, and schools are run; they help determine business promotion policies; they have even attempted to define when life begins.

Excessive litigation results in the misdirection and misallocation of valuable societal resources. Also, litigation can become a means of harassing one's political or ideological opponents; it can bring about the transfer of decision making from the legislative and executive branches of government to the judicial system--which is less well-equipped to handle the task. In other words, by resorting to litigation as a means of resolving a wide range of reasonable and unreasonable disputes, litigation has become a means of paralyzing democratic processes, sapping personal

initiative, and weakening individual responsibility.

We must begin to reverse this explosion in litigation and redirect our attention and resources to other pressing concerns. It is time to reaffirm the principle that our laws come from the body politic.

The next agenda must pursue a number of specific and general tasks such as reducing the burden of law, lawyers, litigation, and legal fees on our society. Several specific recommendations follow:

1. *We must accelerate the deregulation of our legal system and increase competition in the delivery of legal services.* To begin the process, we suggest the following actions:

- We must reduce the number of tasks in our society that are reserved for the exclusive attention of lawyers. Professionals such as bankers, realtors, and paralegals should be empowered to write and execute legal documents and to provide other legal services. Real estate settlements and contracts, divorces, wills, and other agreements can often be handled by qualified professionals. These processes can and must be made simpler and far less expensive.
- In spite of increasing federal attention and various reform efforts, state limitations on legal advertising continue. These

restrictions must be removed and information about legal services must be widely dispersed in order to fully inform our citizens about legal services and choices in their delivery.

- Continued barriers to the practice of law, erected and enforced by professional associations--particularly barriers to interstate practice of law--should be reduced. While it is important that lawyers have a fundamental understanding of the law and legal procedures of any state in which they practice, local professional associations have gone far beyond requiring fundamental knowledge. Such restrictions lessen competition, increase costs, and reduce choices for the citizenry. Reduction of interstate barriers to the practice of law would improve the allocation of legal resources throughout our society.

2. *We must substantially reduce the load on our federal court system.* The following are examples of how this might be done:

- Broadening the use of alternative dispute resolution mechanisms in lieu of the traditional courtroom adversarial process. Various government agencies (the Community Relations Service and the Federal Mediation and Conciliation Service) are in the forefront of encouraging the use of

appropriate alternatives. Arbitration, mediation, and other less formal methods of dispute resolution are important means of keeping disputes from reaching the courts. Additionally, the increased use of "Article 1 Courts" to handle specialized matters such as social security litigation should be encouraged.

- The abuse of habeas corpus by state and federal prisoners must be corrected. Habeas corpus, originally conceived as a narrow remedy for testing the legality of executive detention, has grown through expansive judicial interpretation to the point where it now serves as a mechanism whereby a single federal trial judge can review and overturn the considered judgments of a state's trial, appellate, and supreme courts in a criminal case. The predictable result has been an enormous volume of frivolous habeas corpus petitions to the federal courts.
- We applaud recent efforts to reform and simplify our criminal code, but more needs to be done. Indeed, the success of the criminal code reform bill shows that reform is possible. Additional legislation to curb the abuses in this area and reduce the burdens imposed on courts, states, and federal officials by habeas corpus litigation would give the process a finality that is

vital to an effective judicial system.

- Laws providing for mandatory appeals to the Supreme Court must be narrowed. Requiring the Supreme Court to hear and decide all cases that happen to fall into broadly defined categories, regardless of whether these cases present questions of general public importance, results in an unnecessary expenditure of the time and resources of the Supreme Court.
 - Federal diversity jurisdiction accounts for over 60 percent of all civil jury trials in the federal courts and should be substantially curtailed. Permitting over 60,000 civil cases per year to be heard in the federal courts--cases that differ in no way from hundreds of thousands of cases brought in the state courts, except that the parties on one side of the suit happen to live in a different state than the parties on the other side--is an unwarranted and unnecessary burden on our federal court system. It is at odds with the fundamental precepts of federalism.
 - To reduce the incentives for baseless and harassing litigation, the extent to which losing parties should be responsible for paying the opposing side's legal fees should be expanded.
 - It is becoming increasingly difficult to justify the expenditure of huge sums of public dollars to subsidize the resolution of essentially private claims between well-heeled private applicants. Transferring full court system costs to private parties who can afford them in cases of essentially private litigation should be explored and could provide increased incentives for successful resolution of disputes through alternative means.
 - The vast increase in personal damage suits filed against federal officials is clogging the courts. Personal liability for actions taken in the course of official functions often imposes an unjust burden on public servants. The recommendations of the Attorney General and the Administrative Conference of the United States to control and limit such suits should be adopted.
3. *The unwarranted expansion of the federal courts' judicial policy-making role must be reversed.* We urge increased scrutiny into the areas of particular concern, including:
- The erosion of restraint in determining justiciability has allowed the courts greater power to review government action than is necessary or wise. A stricter challenge to standing, to

ripeness, and to mootness--regardless of the desirability of reaching the underlying legal issues involved--would wisely limit the expansive reach the courts have sought.

- The undisciplined expansion of the doctrines of "fundamental rights" and "implied rights" (into such areas as the right of privacy, the right of interstate travel, and the "general welfare" clauses) have thrust the court system into matters more appropriately reserved for the legislative domain. The judiciary should be urged to forbear from arbitrary policy making by the creation of new and previously undiscerned rights. Working with the Congress, the Department of Justice should begin a systematic review of existing and proposed statutes to assure that key provisions are properly specified and not allowed to be so vague or general as to demand and invite subjective judicial policymaking.
- In the extravagant use of mandatory injunctions and expansive remedial decrees, the courts have gone far past their abilities and purposes to inject themselves into the details of executive and legislative prerogatives. Federal courts, through the use of remedial decrees and mandatory injunctions, run school systems, prisons, and

businesses. This trend must be reversed.

4. *We believe that the accountability of federal judges with lifetime tenure must be improved.* Present redress for inappropriate judicial conduct is insufficient. Periodic reconfirmation of federal judges should be considered, and Congress, through appropriate legislative action, should continue to assert its clear Constitutional authority to review judicial activities that it believes contrary to the spirit of the laws that it has enacted. The Constitution gives Congress the means to do this. Congress should not shirk this important task.

GOVERNMENT AND ETHICS

Federal legislation purporting to regulate the ethics of elected and other officials must be reconsidered in the light of its several failings. Some of the laws are extravagant in their penalties and are therefore seldom enforced. Many serious crimes (such as bribery) are covered by other statutes and are generally not discovered by ethics laws in any event. On the other hand, "ethical" faults that would seem trivial in other circumstances are made sensational issues under present "ethics" laws, especially during political seasons and during media campaigns, sometimes to the degradation of the political process. Indeed, ethics laws are in danger of becoming little more

than political weapons taken up when more substantial issues fail to attract attention. Some of today's ethics laws are as injurious to society as they are helpful.

To remove the sting of controversy from either political party or from any one individual, the President and Congress should appoint a commission of citizens to review the host of post-Watergate ethics laws with an eye toward their revision. Revision in no way implies that the commitment to ethics should be weakened. Rather, in our efforts to encourage ethical behavior among officials, we should make certain that the laws balance the needs of government with the rights of the individual.

POVERTY AND WELFARE DEPENDENCY

The Problem

Whatever a robust economic growth rate may do to the size of the deficit, inflation, or unemployment, it is unlikely to have much effect on welfare dependency. At least since the start of the 1970s, the number of people receiving public assistance has been remarkably insulated from fluctuations in the nation's economy; in bad times, it has gone up a little; in better times, it has gone down slowly, if at all. To be sure, some programs--most notably, food stamps--have been sensitive to the business cycle. And within the aggregate caseload figures, there has been a good deal of

movement in and out of dependency, much of which was in response to changing job opportunities. Nonetheless, the seemingly irreducible number of recipients has been growing larger for every welfare program. The view that a sizable, permanent underclass now exists has been much in vogue lately.

Some would say that these developments are not particularly worrisome, that, on the contrary, they show how successful our social policies have been in responding to persistent need. They argue further that making public assistance still more generous or accessible is the most important item of unfinished business. This, however, seems to be a minority opinion, even among the beneficiaries of these programs. Welfare is disliked among recipients as much (or more) for what it does as for what it doesn't do. It destroys self-respect, it destabilizes families, and it encourages bad work habits. Welfare dependency (and poverty) also seems linked to higher rates of crime, illegitimacy, and educational failure. Finally, although not in the same league as social insurance programs, the cost of public assistance is far from insignificant and weighs especially heavily on state and local budgets.

Yet, for all these baneful consequences, we still have little agreement on how to remove people from welfare dependency or on the reasons for the increase. One school believes that the characteristics of the recipients--their age, employability,

number of children, and so on--are responsible. Another blames the public assistance programs themselves, charging that they are set up and run in a way that offers more incentives for dependency than for self-support. A third view is that not enough jobs of the right kinds and in the right places have been available. There is undoubtedly some truth in each of these explanations, as well as in the theory that a variety of cultural or subcultural trends have eroded the "work ethic" for the poor and for many others.

However, there is overwhelming agreement that something needs to be done about the problem. In contrast to the start of the 1970s, when even raising questions about the growth of welfare dependency was considered reactionary or worse, it is now acceptable even in the most liberal circles. Especially noteworthy is the willingness of black leaders to speak publicly about the harm being done to their communities by welfare. Thus, the time for a major attack on dependency may be at hand.

Policy Background

Not surprisingly, the welfare policy adopted by President Reagan has been much like the one he pursued as Governor of California. It relies on administrative controls to limit dependency to those who are "truly needy." Among the measures proposed in the past four years have been stricter rules for assessing family income in determining welfare

eligibility, stronger work requirements (including the creation of "workfare" programs whereby recipients must accept public service jobs in return for welfare benefits), and expanded efforts to obtain child-support payments from "absent" fathers. With the partial exception of workfare (which remains optional rather than mandatory for the state-run welfare programs), these changes have been enacted and are in various stages of implementation.

Despite the usual cries of alarm that greeted the administration's welfare reforms, evidence that they have produced unnecessary or unfair hardship is difficult to come by. To the contrary, they have plugged a number of loopholes that were long apparent to a wide range of welfare experts.

Their real shortcoming, however, lies in what they do *not* do. Even if the administration's policy were fully implemented and had the desired results, the decline in welfare caseloads would be in the 10 to 20 percent range, a more-than-respectable accomplishment compared to what previous administrations have done, but one that would still leave a level of dependency that, by the standards of then-Governor Reagan, constituted a national "crisis." Furthermore, by ratcheting caseloads upward, the recession has almost certainly doomed the likelihood that the expected reductions will occur. Insofar as the Reagan administration hopes to make any substantial inroads on dependency, it will have to rely on

measures beyond its current welfare reforms.

Unfortunately, since welfare dependency has been so low on the agenda of researchers and policy makers, recognition of it as a problem, let alone the formulation of politically feasible solutions, has been slow in coming. In its second term, the Reagan administration could perform a singular service just by mobilizing public and private resources to deal with this problem.

Recommended Agenda

The administration could also take a number of immediate actions to learn more about alleviating dependency:

1. *Appoint a national commission to report on the quality of family life in the United States.* Divorce, separation, desertion, illegitimacy--these are four horsemen of dependency. The single-parent family, especially the black single-parent family, all but symbolizes this problem; indeed, it is both the cause and primary manifestation. We once thought that changing the incentives of the welfare program might make a difference; we now know it will not. What will work--if anything--remains to be discovered. By setting up an inquiry modeled on the President's Commission on Excellence in Education, the administration could dramatize the adverse consequences of family

breakup, while stimulating a variety of public and private efforts to do something about it.

2. *Remove the tax code's present disincentives to work and family cohesion.* Tax relief for families generally, and for working poor families in particular, will remove some of the incentive to welfare dependency. It will also remove the present inequity wherein one set of poor families works and pays taxes to support another set of poor families. For the past generation, the taxes of families have risen far faster than the tax burdens of other taxpayers, making welfare dependency still more attractive. The administration can make three simple changes that would help remove the present disincentives to work and family responsibility:

- Increase the personal exemption in the income tax (its real value is a fraction of what it was a generation ago)
- Increase the "zero bracket amount" to help remove the very poor from the income tax
- Increase the earned income tax credit (which offsets social security tax).

These steps would help rebuild the family without government interference or the creation of another costly, meddlesome bureaucracy.

3. *Redirect federal research activities in the social policy agencies (especially Health and Human Services, and Labor) to concentrate on welfare dependency.* Two decades ago, there was not a dime's worth of good research on the causes of dependency; there's not much more now, even though the problem has grown immensely. While not attention-grabbing, a research program that asked the right questions could pay handsome dividends in the future.

4. *Upgrade the gathering of pertinent statistics on poverty and redefine officially the poverty threshold.* It does not make sense to cut relatively small statistical programs as a way of saving money, when those programs can provide data useful in achieving more cost-effective policies in the nation's huge welfare spending programs. By the same token, the Office of Management and Budget must implement a new poverty definition that takes account of the value of "in-kind" benefits such as food stamps and public housing when eligibility for welfare is determined. Incomplete and incompletely applied statistical data cost money and distort decisions about who is really in need of aid. Current poverty statistics do not reflect geographic cost-of-living differences, non-cash assets and income, or how many people stay poor for how long. A more useful measure would be to identify a minimum market basket of goods and services (including health insurance) necessary for survival. Those unable to afford this

market basket would be considered poor.

5. *Grant more administrative flexibility to state and local welfare agencies to permit them to try new ways of reducing dependency.* A number of innovative efforts to curb Medicaid costs are now underway, primarily because of a policy of greater receptivity to requests for waivers of federal rules or procedures. A similar openness toward experimentation in the public assistance programs has not been encouraged--but should be.

6. *Reward state and local governments that manage to reduce dependency.* Under the current financing arrangements, a decline in caseloads would enable state and local agencies to save some money (the part paid out of their own revenues), but cost them other funds (the part paid by the federal government). A new financing arrangement--perhaps a block grant instead of a matching formula--should be examined as a way to strengthen the incentives for reducing dependency.

7. *Eliminate exemption of mothers with very young children from work requirements.* Today, more than half of mothers with children under three years old are in the labor force. Yet current welfare programs exempt mothers of very young children from the requirement to seek training or accept public service work, thereby effectively postponing their entry into the labor force by six or more years.

Assuming that appropriate day-care arrangements, formal and informal, and other necessary assistance for the children could be made available, ending this practice could nip welfare dependence before it had really begun.

8. *Restore adoption as a feasible, supported option in out-of-wedlock pregnancy.* Millions of couples of all races wish to adopt, while experience suggests that many women who might consider adoption as a resolution to unwanted pregnancy choose instead abortion or single-parent welfare dependency. They do so because the other options, especially out-of-wedlock child-rearing, are supported by public funds, while adoption is made overly difficult by government regulation and red tape, and is seldom given affirmative support.

This policy error of past generations flies in the face of society's recognition that stable homes are vital to children, and that neglected children are likely to suffer any of a number of disabilities that injure their chances for a productive life and ultimately hurt society itself. Poverty dependency is one of those common disabilities. The administration should allow adoptive parents to deduct from their taxes the costs of the initial adoption (including medical costs) in the same way that most couples may deduct medical costs of a birth. Government policy should allow maternity leave for adoptive mothers if it allows it for others. The present Health and

Human Services efforts to promote adoption of "hard to place" children should be expanded, as should education of state and local jurisdictions to remove legal impediments to adoption. The good offices of the President should be employed on behalf of bringing mothers and would-be adoptive parents together in the interest of the children--and the health of the social order.

EDUCATION AND AMERICAN CULTURE

The Reagan administration's most dramatic achievement in education was to identify, highlight, and legitimize concern about the lackluster quality of American elementary and secondary schooling. It was less successful, however, in attempts to actually change federal education policy.

Major efforts at school deregulation (in handicapped and bilingual programs, for example) were abandoned or defeated; initiatives to foster family choice (tax credits, vouchers) failed. The creation of the Chapter 11 "block grant" to replace a number of categorical programs has worked, some costly new programs have been enacted, but mainly nothing has changed in higher education, and the data gathering and research enterprises are in a state of shambles.

White House attention to compelling education-related issues (such as school discipline) has been strong, and the Department of

Education has tried to develop strong and cordial relations with the professional education establishment. The real engine of education reform, however, is the disgruntled public.

Laymen are a major force in American education today: elected officials (notably governors), business leaders, worried parents, and taxpayers. This group must be incorporated into the policy-making process at the federal level; their views and actions must be heard and solicited. Education professionals should define issues and shape policies only in conjunction with concerned laymen.

Specifically, the following four areas must receive attention:

1. *What should children learn in school?* Recognizing that not every Presidential pronouncement need be accompanied by a spending program or regulation, the administration can safely address this issue without suggesting improper intrusion by the government. To date, the administration has not projected any clear notion as to the content of a good education. The administration could very usefully foster an important national discussion of "what every child should learn."

Any discussion of educational content will encounter those who favor maximum school diversity and parental choice and those who favor the transmittal of a "common culture"

via the schools. This is not easy to resolve, but it is worthy of debate.

As control of the curricula--and of school financing--is fast shifting from localities to the states, a White House summit meeting or national conference might now be appropriate. The President could invite governors, chairmen of state school boards, and chief state school officers, and be prepared to grant "official" recognition of school systems with model curricula.

2. *Our instruments for assessing and appraising educational performance are not good.* The most important education agency in Washington is the National Center for Education Statistics and it is ignored. It gathers a great deal of quantitative data (very little qualitative information) that are hardly used. It does little good to develop clear notions about what children should learn if we have no means of determining whether they actually learn. Improving our research capabilities is critical.

3. *In terms of quality and quantity we are facing a national teacher crisis.* Public schools will hire approximately one million new teachers over the next five years; unless well-established trends are abruptly changed, the great majority of these will lack both the aptitude and the specific knowledge to teach what children need to learn. Even the much vaunted "career ladders" are not likely to have an immediate impact on

the quality of entering teachers. The "teacher problem" has many elements, including pay, working conditions, status, career prospects, and a sense of accomplishment. Serious consideration might be given to the following proposals:

- Year-round teaching contracts with corresponding pay arrangements in order to make teaching a full-time job (The federal government might, for example, subsidize pilot year-round school experiments in willing states and communities.)
- An immediate enlargement of the pool of eligible teachers by devising alternate certification schemes that still afford quality control
- Initiatives to upgrade teacher status and morale
- Increased opportunities for renewing, retraining, and updating the knowledge base of new as well as experienced teachers
- Incentives for the school systems and teacher unions to develop greater "professionalism" with regard to teaching, including quality control of entrants, peer review, and responsible handling of incompetents.

4. Quality problems in higher education are numerous and manifest and are only beginning to surface (in a

recent report of an NIE study panel, and by the NEH Chairman). It is easy for nonacademics to be accused of impropriety when addressing themselves to shortcomings of the academy; nonetheless there is much to be said and done:

- Building a "merit" component into student aid (this being by far the largest and costliest form of federal post-secondary spending)
- Developing suitable measures and assessment techniques for determining what students actually learn while in college
- Commissioning studies of peer review (of faculty quality, research quality, etc.) and initiating various other mechanisms for the academy to regulate its own quality, including accreditation (Self-regulation is, of course, the preferred rule, but is it working sufficiently well, and, if not, can it be improved?)
- Calling attention to the poor quality of academic leadership on most campuses.

The basic question inherent in much of the debate over education policy is "Does the United States possess any sort of 'common culture' that its educational institutions--schools and colleges, public and private--ought to impart to students, regardless of their individual

differences and diverse heritages?" This may be the most difficult question facing our educational system and the resistance to an affirmative answer is fierce. If we are ever to assimilate our immigrants, make our minorities feel less estranged, and develop a level of "cultural literacy" that fosters civic responsibility and patriotism, we may need to restate the centrality of a common but not an exclusionary culture--a culture that, in other words, combines many strands but is shared by all.

HEALTH CARE DELIVERY

The Problem: Cost

Since 1960 national expenditures for health care have risen by 100 percent, far outpacing both the rate of inflation and the growth of other sectors of the economy. Health spending now absorbs almost 11 percent of the nation's gross national product, up from 5 percent in 1960.

This is a problem of unchecked government spending as well as an issue of national resource allocation. Since health care is paid for primarily through insurance premiums and payroll taxes, it represents a significant proportion of employee compensation and therefore affects business costs and competitiveness.

Clearly, this spectacular escalation of medical care payments cannot

be sustained; more cost-effective ways must be found to deliver quality care. Such solutions have proved stubbornly elusive.

At the heart of the problem is the nearly complete absence of market mechanisms in the health delivery system. The fee-for-service, third-party payor system that has developed gives no incentive to individuals to minimize health spending, and no incentive to health care providers to reduce costs. Since virtually all purchasing decisions are made by the doctors and hospitals that provide the care, no market exists. Indeed, studies have found that increasing the supply of doctors raises rather than lowers health care prices.

The Objective: Controlling Costs

In 1982 the Reagan administration proposed, and Congress ultimately enacted, legislation to change the system by which hospitals are reimbursed from "cost-plus" to "fixed" payments based on the type of diagnosis (Diagnostic Related Groups, or DRGs). The new system was implemented on October 1, 1983, and early results appear encouraging.

Additional measures are being considered, such as cost controls on doctors and hospitals, increased reliance on Health Maintenance Organizations (HMOs), higher deductibles paid by patients, and reduced investment in advanced medical technology.

In deciding which alternatives to pursue, two principles should be kept in mind:

- Just as there is no single villain, there is no single solution. A multifaceted approach is necessary.
- While it may be too much to hope for a true market in health care, every effort should attempt to create market-like incentives within the system. Individuals must be encouraged to use fewer, less costly health care services, and providers must be encouraged to deliver the least expensive care consistent with the standards of their profession.

There will be predictable cries of outrage against some of the suggested changes, particularly against those that encourage individuals to take greater responsibility for their own health. Nonetheless, the urgency of the cost crisis demands bold action.

Recommended Actions

1. Encourage competition in health care delivery:

- Reorient the DRG approach to cover care by doctors, and encourage state and private coverage plans to match the federal system. The evidence to date is sufficiently positive to warrant broader coverage. This

measure should help limit cost shifting.

- Encourage greater use of HMOs and Preferred Provider Organizations (PPOs). HMOs provide fixed-cost care using groups of salaried physicians rather than fee-for-service private doctors. PPOs provide reduced rates to companies that contract for the services of their members, but allow individuals to choose their doctors and preserve the fee-for-service structure. There is evidence that both types of organization can cut the cost of health care, primarily by reducing hospitalization.
- In cooperation with the states, develop a comprehensive plan to limit medical malpractice suits. Hospitals and doctors argue, with considerable justification, that one of the main factors encouraging "overtesting" and the overuse of surgery is the threat of medical malpractice suits in cases where anything less than the "best medical practice" has been prescribed. Estimates are that malpractice insurance adds \$1.7 billion annually to hospital charges, not including the \$15 billion for tests performed, to avoid liability claims. The legitimate need for legal redress in cases of true malpractice is obvious; the present system, however, has the perverse impact of discouraging cost-efficient care,

thus escalating medical operating costs.

2. Encourage individuals to use less and less costly health care:

- Support the increased use of higher deductibles and copayments in both federal and private plans. One of the most pernicious impacts of the current health care system is that individuals are often not financially responsible for their care. The original idea behind health care insurance--that no seriously ill person should suffer a financial catastrophe because of that illness--has been turned on its head to the point where individuals bear none of the burden of paying for their own health care. Higher deductibles will properly shift the balance, encouraging individuals to be more discriminating buyers of health care.
- Shift the cost burden primarily to individuals for elective procedures and treatment of nonessential conditions (e.g., routine checkups, drugs to control diet, etc.). The federal government has great power to discourage "rich" benefit plans by changing the deductibility provisions of the tax code. The administration proposed such a plan once before and should do so again.
- Permit corporate tax deductions for plans that offer

reimbursement for deductibles. These innovative corporate plans offer individuals an incentive to minimize their use of care by directly paying them part or all of the unused allocation for the year. The Treasury Department, for understandable reasons, has denied the deductibility of such payments. In this case, the priority to reduce health care costs should override the need to maintain the integrity of the tax code.

THE WORK FORCE

The Issue

The United States economy is undergoing profound structural shifts. The decline of basic industries, the rise of new ones, and intensifying foreign-based competition are only the most visible signs of the changes now underway.

American workers are poorly prepared to adapt to these shifting economic circumstances. Their academic skills are deficient, and their functional skills are fast becoming obsolete. Most important, America's educational and training institutions are inadequately prepared to help workers make the transitions they face.

If the U.S. economy is to remain competitive, the major focus of training policy must be the improved performance of the entire labor force.

This requires public and private education, training, and retraining for:

- Hard core unemployed youth
- The functionally illiterate
- Those entering the work force
- Those who are employed
- Displaced workers.

Background

In the late 1980s and early 1990s, the U.S. will have worker shortages. These shortages will be created by the combination of growth in the U.S. economy and a dramatic slowdown in the rate of expansion of the American labor force. With the maturation of the post-World War II "baby boom" generation, half as many new workers will enter the work force in the 1980s as in the 1970s; in the 1990s, half as many as in the 1980s.

Thus, today's workers will be tomorrow's workers: They will constitute almost 85 percent of the work force in the year 2001. For at least the next two decades, therefore, employers will be forced to draw primarily from today's labor pool to fill pressing job vacancies.

The training and education needs of these workers will vary widely. The capacities of potential providers of

training also vary. The challenge is (1) to sort out responsibilities for meeting these distinct training needs so that they reside with those best able to provide them and (2) to facilitate the on-going economic adjustment of firms and workers with minimal political intrusions.

The Hard Core Unemployed

Unemployed black and hispanic youth constitute a major portion of the nation's hard core unemployed. They have limited work experience, plus educational deficiencies, and therefore encounter great difficulties making the transitions between school and work and from job to job. Most come from families with few resources. The preparation of these youth for jobs is time-consuming, troublesome, and costly. It exceeds the financial capacity of most state and local governments or the willingness of most employers.

After almost two decades of experiments with various approaches, the primary responsibility for *financing* the training of the hard core unemployed has been assumed by the federal government. But locally operating training institutions have proven best equipped to actually provide training and to be match-makers between trainees and potential jobs. This division of responsibilities was written into national legislation--the Jobs Training Partnership Act of 1982.

Illiterate and Impaired Workers

At least 30 million American adults are poorly equipped for work because they are functionally illiterate. Another 1.3 million adults cannot understand or speak English. Yet many of them are employed and their employers often provide and finance remedial assistance. A Conference Board study reveals that 36 percent of the largest 2,000 companies provide remedial education.

Where private employers do not offer such assistance, however, community, volunteer, and public sector programs are required. They are particularly critical for two important segments of the work force--the unemployed, whose needs are often most extensive, and those who work for small firms, which typically lack both the resources and capacity to provide such education.

Entry-Level Workers

At least 1 million to 1.5 million new workers will enter the work force each year for the foreseeable future. Most will require some advance preparation and many will receive it through public training and education programs. Yet the nation's public training system is rapidly becoming inadequate: quick-paced technological change is rendering equipment obsolete, skills are becoming antiquated, the labor-market information programs of the federal and state governments are only

marginally effective, and existing training programs inadequately address the training needs of employers.

Employed Workers

Most of the nation's employed workers will require "booster shots" of education and training throughout their careers. These can best be supplied by employers who know their needs and are usually equipped to provide the necessary training. The appropriate role of government is to provide incentives for companies to make these kinds of investments, similar to the incentives now provided for business investment in modernized plant, equipment, and technology.

Displaced Workers

A large but unknown number of workers will be displaced from their jobs within the foreseeable future, simply because of basic changes in the structure of the economy. Displaced workers are often poorly prepared to make necessary transitions: they have few savings, inadequate education, strong community and family ties, and advanced age. The trauma created by the expectation of lifetime employment and the reality of displacement results in confusion and inertia.

Past experience with federal displaced-worker programs strongly suggests that new government-oriented programs would not be

effective. A more useful approach would be for business, workers, and government to work together to share responsibilities for retraining.

Recommendations

A flexible national training strategy--as opposed to a federal training strategy--is necessary. It should take a broad-based approach to improving the skills and adaptability of U.S. workers and involve the private sector, all levels of government, and the workers themselves. The strategy must be structured so that each component provides the service it does best--its comparative advantage. Such a policy should emphasize the following:

1. *Continue support for the Jobs Training Partnership Act.* This program appears to be working well. It merits continued support by the administration.

2. *Modernize the nation's system of vocational schools, technical institutes, community colleges, and four-year colleges.* The federal government should eliminate categorical restrictions on aid to state vocational, technical, and community college programs. Federal assistance should be refocused on the mission of modernizing training equipment and faculty skills of these institutions.

3. *Provide incentives to business for additional investment in training.* Employers are given few incentives by government to upgrade the skills

and performance of their workers, but are given incentives to invest in modernized plant, equipment, and technology. A bias has been created by unbalanced public policy. Thus, one of two actions is required--either eliminate existing incentives for investment in capital and technology or create comparable incentives for investment in worker training.

If the federal government is to continue incentives for investment by business, it is recommended that these incentives be in the form of a block investment credit--that is, usable at the discretion of the firm for investment either in plant, equipment, R&D, worker training, or some combination. Such an approach would provide incentives that (a) are automatic and usable at the firm's initiative, (b) stimulate additional investment by firms rather than subsidize what is already being done, (c) permit maximum flexibility by the firm in determining both its specific needs and the best way to meet these needs, and (d) have little administrative red tape.

Block investment tax credits would involve lower administrative costs than direct public financing, could be targeted, and would stimulate increased private investment. They require no additional federal bureaucracy or overhead. Companies make the decision on whether and how to participate. If not needed, they are not used and thus involve no cost to the public. If they are used, the firm pays the majority of the investment so

that the government contribution is more likely to be better spent.

4. *Eliminate barriers to training and worker adjustment.* Many government-created barriers impede worker adjustment and training. A majority of the states, for example, prohibit workers drawing unemployment insurance from engaging in training or retraining. These barriers must be identified and eliminated.

5. *Create a comprehensive displaced worker assistance program financed by workers and employers.* The federal government now has an incoherent maze of 22 displaced worker programs that should be eliminated. In their stead, there should be a new approach with the following characteristics: (a) individual choice, (b) administrative simplicity, (c) self-financing, (d) maximum flexibility, (e) comprehensive coverage, and (f) assured financing. The linchpin of such a program is the creation of a new financing mechanism that can guarantee the availability of retraining and relocation assistance for those who need it.

There are several ways to finance a comprehensive and flexible displaced worker assistance system:

- Use some part of the workers' existing unemployment insurance entitlements.
- Create a new payroll tax.

- Create a wholly new self-financing mechanism--the Individual Training Account (ITA)--that permits workers and employers to create funds for retraining. *An effective self-financing mechanism should be high on the administration's training agenda.*

IMMIGRATION

The Problem

Illegal immigration into the United States is considerable--perhaps half a million or more people each year. Some eventually return to their countries of origin; others remain. Estimates are that there are now between 2 million and 6 million illegal aliens in this country. About half of these immigrants are thought to come from Mexico, a country of some 70 million people that will probably double its population in 20 years.

Public concern about illegal immigration into the United States heightened in 1980 when the Mariel boatlift brought in 125,000 Cubans, and illegal Haitian immigration increased substantially. But proposals to deal with the problem do not concern the Cuban and Haitian situations, which have been addressed by other means.

A variety of consequences are thought to flow from illegal immigrations: jobs taken from U.S. citizens,

pressures on the communities near the Mexican border, the fact that we have "lost control of our borders," and the existence of a sub-class living in America without full access to various services such as health care. Others, however, note that the flexible access of aliens, especially Mexicans, to our labor markets benefits U.S. growers and provides a safety valve for Mexico--probably an important one, given the problems in Central America with revolutionary movements. In addition, they point to studies showing that most illegal immigrant workers are paid at least the minimum wage and that, in any event, there are laws on the books that protect all workers.

Other issues in the area of immigration policy (e.g., the preference system for legal admission that emphasizes family reunification and underemphasizes skilled labor) should be reviewed in any new comprehensive immigration legislation. But the issue of major concern has been the extent of the illegal immigration in recent years.

Background

The problem was considered at length by the Select Commission on Immigration and Refugee Policy, which reported in early 1981, and by the Reagan administration via a special task force headed by the Attorney General. The Commission, the administration, and concerned

Congressional leaders all supported a three-part solution:

- Civil and criminal penalties for employers who knowingly hire illegal aliens (it is not now illegal to do so)
- A system enabling employers to determine who is here illegally and is therefore ineligible to work
- Amnesty for illegal immigrants who had taken up residence in the United States as of a certain date.

Employer Sanctions

The logic behind employer sanctions was that they would deprive illegal aliens of what is presumably their major reason for coming here: the opportunity to work. Employer sanctions were adopted as the centerpiece of the proposed policy to close off access of illegal immigrants to U.S. labor markets.

National Identification System

Employer sanctions, however, provide an inherent incentive for discrimination: The easiest way to comply with the law is not to hire anyone who looks or sounds foreign. To counter the potential for such discrimination, employers were to be required to check the identification of *all* new hires.

The problem is that most sources of identification--drivers' licenses, social security cards, and birth and death records--are easy to counterfeit and obtain fraudulently. The need for a tamper-proof and counterfeit-proof national identity system logically follows from employer sanctions, and the Senate version of the legislation called for the eventual establishment of such an identification system.

Amnesty

The several million illegal immigrants who have taken up residence here and who are an important part of the work force in some parts of the country would, under an employer-sanctions regime, be ineligible to work. Deportation of these people is neither possible nor desirable. Instead, the employer-sanctions approach requires that they be offered a way to change their status to that of legal residents--the way to do this is through granting them amnesty.

It is not known how many of these immigrants already have the documents necessary to function as de facto legal residents--drivers' licenses, social security numbers, and other standard forms of identification. Nonetheless, there is considerable concern that amnesty would greatly increase the number of people eligible for social benefits such as Medicaid, AFDC/food stamps, and the like. There is also concern that amnesties tend to reward those who have entered illegally, while penalizing

those who seek legal admission, and to encourage illegal immigration in the hope of another amnesty program in the future.

Basic Issues

The immigration legislation known as the Simpson-Mazzoli Bill failed in conference in September 1984 after many years of debate. The irreconcilable differences between the House and Senate occurred over issues of fundamental values, not over dollar amounts. For example:

- The potential for discrimination by employers vs. the mandate not to hire illegal workers
- The potential burden of a new bureaucracy vs. the need for an appeals process for those discriminated against
- The potential abuse of civil liberties vs. the need to exercise rigorous control over identity documents
- The potential punitive effect of amnesty on those awaiting legal entry vs. the need to rationalize the status of the millions here illegally.

The employer-sanctions approach to illegal immigration presents many challenges to basic American values. But even if some compromise were reached, it is highly unlikely that the legislation would be effective. Counterfeiters, for example, could

forge all documents to verify eligibility for work. The amnesty would encourage further illegal immigration. And if employer sanctions do not work, should we then impose landlord sanctions?

Recommendations

The employer-sanctions approach to illegal immigration is fundamentally flawed. The administration should, instead, develop a positive immigration policy that would, while not providing perfect solutions, be of benefit to the United States in both its domestic and foreign policy goals. Such a policy might emphasize (far more than recent proposals) the following:

1. *An expanded and improved border patrol to make illegal entry more difficult.*

2. *Improved internal enforcement of existing labor legislation to make sure that all members of the work force are treated in accordance with legislated standards and are protected from exploitation.*

3. *Legislation and/or regulations to reduce or eliminate access of illegal immigrants to social transfer payments based on need.*

4. *Increased emphasis on citizenship requirements to ensure that new citizens have the skills needed for full participation in U.S. political and economic life--For example, although the U.S. should develop its language training programs, English should be the country's only official language. Bilingual education is deleterious to the assimilation of new Americans. Where necessary, local school systems can use remedial programs in other languages to help teach English.*

5. *Differential policies with respect to Canada and Mexico that recognize the importance of these nations to our long-run security--These might include an expanded temporary worker program, increased long-term economic assistance to help stem the outflow of their nationals, and more aggressive diplomatic relations over immigration issues of their nationals.*